# RETURNING SOCIAL SECURITY TO PAY-AS-YOU-GO FINANCING: IMPACT ON BENEFITS AND THE FEDERAL BUDGET DEFICIT

## JOINT HEARING

BEFORE THE

## SELECT COMMITTEE ON AGING

AND THE

## SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT

OF THE

## SELECT COMMITTEE ON AGING
## HOUSE OF REPRESENTATIVES

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# RETURNING SOCIAL SECURITY TO PAY-AS-YOU-GO FINANCING: IMPACT ON BENEFITS AND THE FEDERAL BUDGET DEFICIT

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WEDNESDAY, FEBRUARY 28, 1990

U.S. HOUSE OF REPRESENTATIVES,
SELECT COMMITTEE ON AGING, AND THE
SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT,
*Washington, DC.*

The committee and subcommittee met, pursuant to call, at 10:04 a.m., in Room 2322, Rayburn House Office Building, Hon. Edward Roybal (chairman of the committee), and Hon. William J. Hughes (chairman of the Subcommittee on Retirement Income and Employment) presiding.

Members present: Representatives Roybal, Hughes, Lloyd, Oakar, Vento, Borski, Bilbray, Pallone, DeFazio, Regula, Shumway, Snowe, Tauke, Courter, Schneider, Ridge, Saxton, Bentley, Clinger, Morella, and Porter.

Staff present: Paul Ceja, general counsel; Valerie Batza, executive assistant to staff director; Diana Jones, staff assistant, Select Committee; Brian Lutz, staff director; and Amy Melnick, research assistant, Subcommittee on Retirement Income and Employment.

## OPENING STATEMENT OF CHAIRMAN EDWARD R. ROYBAL

Chairman ROYBAL. The committee will come to order.

Ladies and gentlemen, this morning's hearing is a joint hearing of the full Committee on Aging and the Subcommittee on Retirement Income and Employment.

We are here to discuss an issue that is critical to both current and future retirees, and to the economic health of this Nation; that is, the financing of the Social Security system. Recently, various proposals have been introduced which would change the way that the Social Security system is financed, moving away from the current method of building up Social Security trust fund reserves and returning Social Security to a pay-as-you-go financing approach.

These proposals have generated much controversy. I believe that they have had the positive effect of forcing Congress to ask some fundamental questions and to confront some realities about the future of Social Security, the Federal budget, the deficit, and how we are currently paying for the general operation of our Government.

The debate over the recent Social Security proposals has also highlighted some basic inequities in how our Government is currently being financed. It has shown how our tax system has become less progressive, if not regressive, because of the increasing reliance being placed on the Social Security payroll tax.

In effect, the Social Security payroll tax is financing the Federal budget deficit and the day-to-day operations of the Government. We are going to try to find out more about this situation. We hope that the witnesses that will make their presentations will help this committee in making a final determination. In addition, before making changes to the Social Security financing system we need to move cautiously and examine the impact of any proposal on current and future beneficiaries.

We must also examine the impact of any Social Security financing proposal on the Federal budget and ensure that additional deficits that may result will not put at risk the economy and those non-Social Security domestic programs that benefit the poor, the elderly, and the disabled, through possible additional spending cuts.

[The prepared statement of Chairman Edward R. Roybal follows:]

OPENING STATEMENT
CHAIRMAN EDWARD R. ROYBAL

"RETURNING SOCIAL SECURITY TO PAY-AS-YOU-GO FINANCING: IMPACT ON BENEFITS AND THE FEDERAL BUDGET DEFICIT"

Today's joint hearing is to discuss an issue critical to both current and future retirees, and to the economic health of this nation: The financing of the Social Security system.

Recently, various proposals have been introduced which would change the way the Social Security system is financed, moving away from the current method of building up Social Security trust fund reserves, and returning Social Security to a pay-as-you-go financing approach. While these proposals have generated much controversy, I believe that they have had the positive effect of forcing us to ask some fundamental questions, and to confront some realities about the future of Social Security, the federal budget deficit, and how we are currently paying for the general operation of our government.

The debate over the recent Social Security proposals has also highlighted some basic inequities in how our government is currently being financed. It has shown how our tax system, as a whole, has become less progressive, if not regressive, because of the increasing reliance being placed on the Social Security payroll tax, and the surpluses that are being created by it. In effect, the Social Security payroll tax is financing the federal budget deficit and the day-to-day operation of our government.

The Social Security payroll tax falls most heavily on low and middle income workers, and we should not be asking those who can least afford it to disproportionately carry the burden of making our government run. We must find other more equitable ways of reducing the deficit and financing government.

We must move cautiously, however, before making changes in the Social Security financing system, such as cutting the Social Security payroll tax. We need to thoroughly examine the potential impact of all such proposals, not only on the current generation of Americans, but on future generations as well. Specifically, we must insure that the long-term financial integrity of the Social Security system is maintained, and that the benefits of current and future beneficiaries are not jeopardized. In addition, we must insure that we do not put an overwhelming tax burden on future generations to pay for the Social Security changes that we may make today.

Finally, we must examine the impact of any proposal on the federal budget, and insure that additional deficits that may result will not put at risk the economy, and those non-Social Security domestic programs that benefit the poor, elderly and disabled, through required additional spending cuts.

We have before us today a distinguished group of experts in both Social Security and federal budget matters. It is my hope they will provide us with the some of the insight we will need to address these important Social Security and budget issues that are facing us in this session of Congress.

Chairman ROYBAL. We have before us a distinguished group of experts in both Social Security and the Federal budget matter. I'm looking forward with great interest to their presentations.

Before we do that, I'd like to recognize my cochairman, Mr. Hughes, and ask him to make an opening statement.

## OPENING STATEMENT OF CHAIRMAN WILLIAM J. HUGHES

Chairman HUGHES. Well, thank you very much, Mr. Chairman, and good morning, ladies and gentlemen. Welcome to this joint hearing of the House Select Committee on Aging and the Subcommittee on Retirement Income and Employment.

Mr. Chairman, it is a privilege to join with you in cochairing these hearings today, and I look forward, as the new chairman of the Subcommittee on Retirement Income and Employment, to working with you on this and many other issues of concern to this committee.

We are here today to examine a number of crucial issues before this Congress, and I think there are about three questions in particular which are vital to today's discussion. First, what is the status of the Social Security trust funds? Second, if Social Security were to return to a more of a pay-as-you-go financing system, what would be the impact on the Federal budget deficit, the economy, and the Social Security benefits both now and in the future? Third, is the Nation willing to address the fact that the general operating deficit of the Federal Government, not counting the Social Security trust fund reserves, is presently over $200 billion and growing?

I would point to these charts over here to just demonstrate, what the issues really amount to. That top bar on the first chart shows the deficit without the Social Security trust funds. It indicates that the deficit, without the Social Security trust funds, is about $206 billion now, and it rises steadily until about the year 2000 when the deficit, without Social Security trust funds, remains at $268 billion.

That second blue bar is the deficit including Social Security, and you'll see that it is $140 billion. The deficit would steadily decrease to the year 2000 when it would be about $30 billion. So we're going to have a deficit, even with Social Security being counted, of $30 billion by the year 2000.

Finally, that bottom graph that swings upward shows the Social Security trust funds at roughly $65 billion today. It increases each and every year to the year 2000 when the Social Security trust funds under present projections will be $236 billion.

At the outset, I would like to emphasize that the Social Security program is in excellent financial shape. There is a lot of speculation about the Social Security trust fund and a lot of uneasiness. I'm sure you experience it when you're back home, Mr. Chairman and colleagues, as I do; people are worried that perhaps, once again, Social Security is unstable. That's not so. In fact, one of the reasons we're here today is because the program has collected $158 billion in additional revenues which are not needed to pay current beneficiaries.

According to the intermediate projections of the Social Security trustees, under the present financing system, the trust funds will

rise to nearly $12 trillion by the year 2030. We will hear more about this topic from some of our witnesses today. In the second chart you can see that today we have about $.2 trillion, about $200 billion in the trust funds. That will rise to the year 2030 to almost $12 trillion before it drops down, under present conditions and projections, to about $1.4 trillion in the year 2045.

There has been some recent confusion in the media on this issue, but I think I can speak for many of the Members of Congress when I say that we would not attempt to jeopardize the retirement security of older Americans. Social Security is a promise—it is a compact—to American workers and retirees, and it will be kept. It is my hope that today's hearings will provide us with a variety of perspectives on these very complex issues.

We're very fortunate to have with us some of the best experts in the country on these subjects. I greatly appreciate your taking the time to be with us here this morning.

I might say the staff has done an excellent job, Mr. Chairman, in crafting this particular hearing. I look forward to hearing the testimony.

Thank you.

[The prepared statement of Mr. Hughes follows:]

STATEMENT OF

THE HONORABLE WILLIAM J. HUGHES, CHAIRMAN
SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT
HOUSE SELECT COMMITTEE ON AGING

JOINT HEARING

"RETURNING SOCIAL SECURITY TO PAY-AS-YOU-GO FINANCING:
IMPACT ON BENEFITS AND THE FEDERAL BUDGET DEFICIT"

WEDNESDAY, FEBRUARY 28, 1990, 10:00 AM
2322 Rayburn HOB

Good morning, ladies and gentlemen. Welcome to today's joint hearing of the House Select Committee on Aging and the Subcommittee on Retirement Income and Employment. It's an honor to serve as a Subcommittee Chairman under your leadership, Mr. Chairman. I look forward to many more joint endeavors.

We are here today to examine a number of complex issues that cut across virtually everything else we will do this session of Congress. The purpose of today's hearing is to begin healthy debate on the pros and cons of various proposals to remove the Social Security trust funds from calculations of the Federal budget deficit and to return Social Security to more of a "pay-as-you-go" system.

While there are a number of important issues related to this topic, I think there are three questions in particular which are vital to today's discussion. First, what is the status of the Social Security trust funds? Second, if Social Security were to return to more of a "pay-as-you-go" financing system, what would be the impact on the Federal budget deficit, the economy, and Social Security benefits - both now and in the future? Third, is the Nation willing to address the fact that the general operating deficit of the Federal government - not counting the Social Security trust fund reserves -is presently over $200 billion and growing? (See Chart 1 - Deficits)

At the outset, I would like to emphasize that the Social Security program is in excellent financial shape. In fact, one of the reasons we are discussing these issues today is because the program has been so successful. Over the past few years, the Social Security trust fund reserves have collected $158 billion more in revenues than was needed to meet the obligations of current beneficiaries. According to intermediate projections of the Social Security trustees, under the present financing system, the trust funds will rise to nearly $12 trillion by the year 2030. We will hear more about this topic from some of our witnesses here today. (See Chart 2 - Trust Funds)

While there has been some recent confusion in the media regarding this issue, I think I can speak for many members of the Congress when I say that we will in no way act to jeopardize the retirement security of older Americans. Social Security is a promise to American workers and retirees, and it will be kept.

The strength and financial solvency of the trust funds is very clear. However, what I am disturbed about is the current trend toward funding the federal government's general operating budget with less progressive taxes, and how a growing general operating budget deficit is affecting Social Security, family incomes, and the economy.

According to the Congressional Budget Office's (CBO) most recent budget document, federal taxes in 1990 are less progressive than they were in 1980. CBO concluded that increased reliance on social insurance payroll taxes is the major explanation for the reduced progressivity of the tax system.

CBO also determined that between 1980 and 1990, average adjusted real income of the top one-fifth of families rose by more than 30%. In comparison, the average income of families in the bottom four-fifths either rose much more slowly or actually declined, as is the case with the lowest income family groups.

This trend distresses me. The working men and women of America pay the Social Security payroll tax each month - willingly and with very few complaints. They believe, and rightly so, that the system works because it is a social contract between, and for all generations of Americans. Each worker contributes to a system that not only pays retirement benefits, but also protects every working American and every American family from disability or an untimely death. That's important protection.

The problem lies in the fact that a significant portion of the Social Security tax workers pay, ostensibly for Social Security purposes only, is being legally diverted to roads, schools, tanks, any number of items that are a part of the operation of the U.S. government. Social Security taxes, like all other government revenues, are deposited in the U.S. Treasury. The taxes are accounted for separately, on paper, through the posting of non-marketable securities to the Social Security and Hospital Insurance trust funds. The Social Security trust funds have $158 billion dollars posted to them in the form of obligation issued or guaranteed by the United States Government.

However, these surpluses have been borrowed to help pay the cost of the Federal government's current operating budget. Is it right to tax wages, at a flat rate and with a wage cap, to pay for the general operation of the government?

During the 1980's, the Social Security tax rose 25%, while corporate and excise taxes have decreased significantly. By 1990, 77 percent of families who pay Social Security payroll taxes will

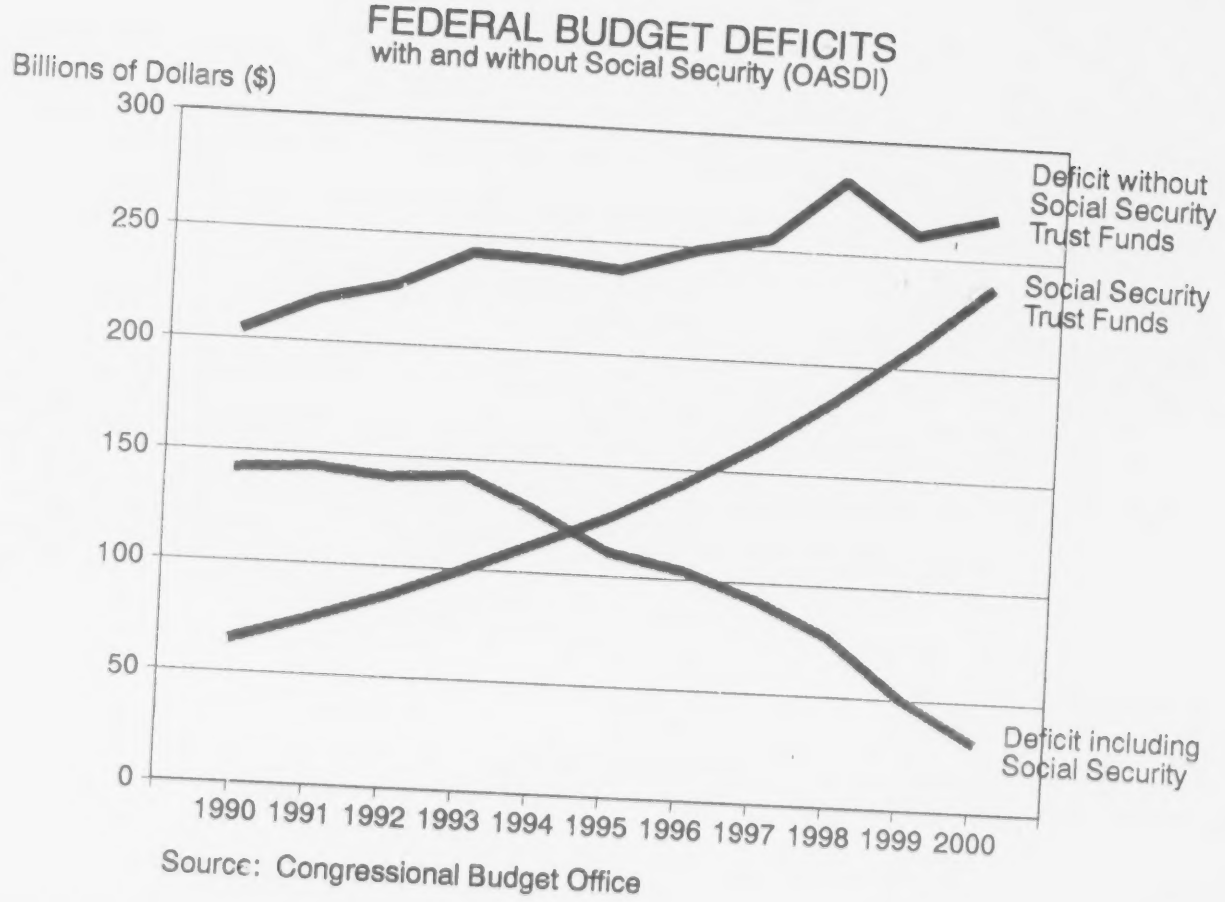
pay higher payroll taxes (counting both employee and employer portions) than federal income taxes. In 1977, 58 percent of these families paid more in payroll taxes than in income taxes. No wonder this system doesn't seem fair to many average working Americans.

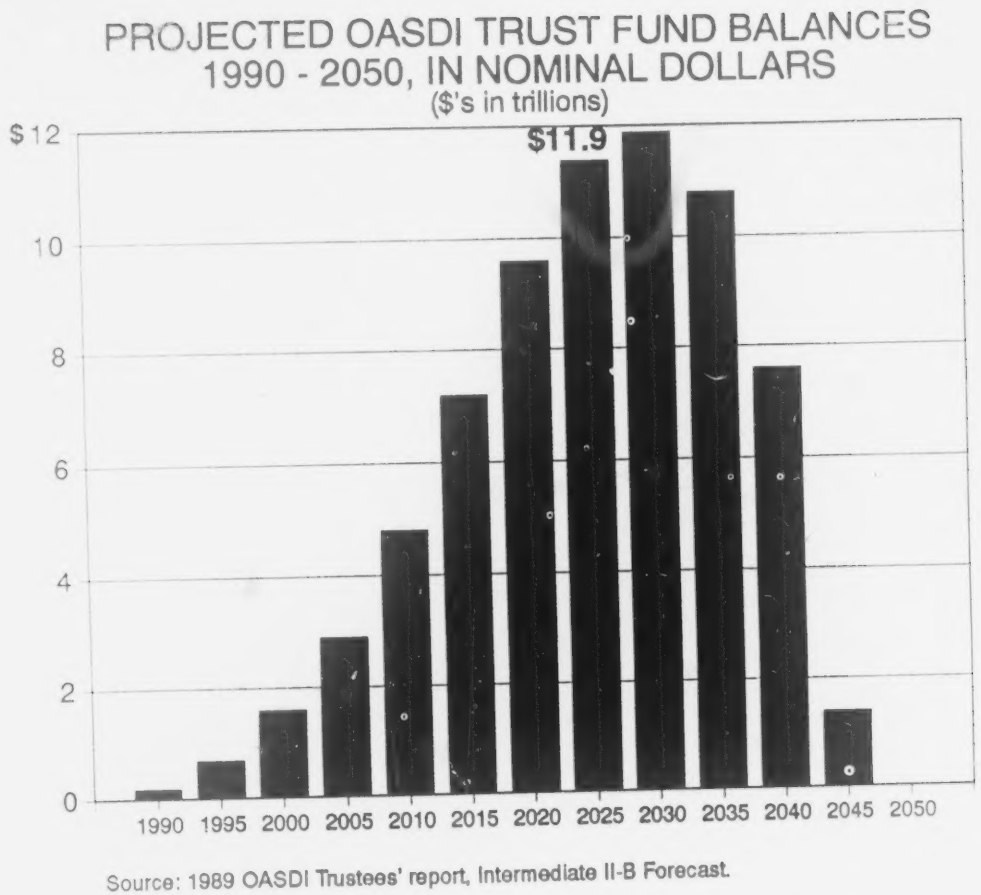
Can the Social Security reserves pay for the retirement of the baby boom generation? According to CBO, "future benefits will have to be paid by goods and services produced in the future". I think it is our duty as Members of Congress to explore options which will help us plan effectively for the retirement of all our workers - both now and in the future. I only question if our current practices are accomplishing that goal.

It is time to look at the results of the 1977 amendments and the 1983 Commission. They accomplished a great deal by re-establishing public confidence and putting the system on a sound financial track. But, when I look at the chart of the role the trust funds are playing financing the deficit I become discouraged. The reality is, we are not cutting the non-Social Security deficit significantly, but rather we have been increasing the Social Security part of the equation. We have two members of that Commission, Mr. Myers, and Mr. Ball, and I welcome them here today to give us their expert opinion on the appropriateness of returning Social Security to a pay-as-you-go system at this point in time.

While we have a tough job ahead of us in sorting through solutions to these important issues, I am looking forward to hearing from the panel of expert witnesses we have with us today who can help shed some light on this topic which concerns all Americans.

I thank all of you very much for taking the time to appear before the Committee - I am sure you are all very much in demand these days and we appreciate you appearing before us today.


FEDERAL BUDGET DEFICITS
with and without Social Security (OASDI)
Billions of Dollars ($)
300
250
200
150
100
50
0
1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000
Deficit without Social Security Trust Funds
Social Security Trust Funds
Deficit including Social Security
Source: Congressional Budget Office




Source: 1989 OASDI Trustees' report, Intermediate II-B Forecast.

Chairman ROYBAL. The Chair will now recognize Mr. Tauke.

## STATEMENT OF REPRESENTATIVE THOMAS J. TAUKE

Mr. TAUKE. Thank you, Mr. Chairman.

Mr. Chairman, I join with the Chair of our subcommittee in commending the staff for the excellent job they have done in arranging for this hearing and providing background information for the members of the committee.

Mr. Chairman, I'd like unanimous consent to submit a statement for the record.

Chairman ROYBAL. Without objection, it will be the order.

[The prepared statement of Mr. Tauke follows:]

STATEMENT FOR THE RECORD
THE HONORABLF TOM TAUKE
JOINT HEARING OF THE SELECT COMMITTEE ON AGING AND THE
SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT
FEBRUARY 28, 1990

I commend Chairmen Roybal and Hughes for convening this important hearing to discuss the status of the Social Security system. During recent weeks, a great deal of attention has been given to the financing of the Social Security system. This hearing provides us with an opportunity to examine key Social Security issues and program objectives. In addition, I am hopeful that we will allay many seniors concerns about the financial condition of the Social Security system.

Over a decade ago, lawmakers frequently faced the prospect of a bankrupt Social Security system. By 1982, it was clear that without a significant boost in revenues the system would be bankrupt by June of 1983. President Reagan appointed a bipartisan commission to study policy alternatives and make recommendations to the Congress to "save" the system.

That commission made recommendations that called for an acceleration of scheduled payroll tax increases. The "rescue" legislation of 1983 was based on the most pessimistic economic assumptions. On this basis, the Congress was fairly confident that the 1983 amendments would keep Social Security on steady ground.

As the 1983 amendments took effect, the economy rebounded. The Trust Fund began to accumulate larger than anticipated

surpluses. (The commission did not expect that the Trust Fund would mount the current reserves until the mid-1990's.) Thus, the system is in better shape than the commission originally envisioned.

Under the Gramm-Rudman-Hollings deficit reduction law, the Social Security Trust Fund (and all other federal trust funds) are counted in determining both the size of the deficit and the annual deficit reduction targets. Counting all trust funds toward deficit reduction makes our job easier because the Congress can avoid making tough choices on how to meet the annual deficit reduction targets. On paper, last year's budget deficit was about $150 billion. However, simply removing the Social Security Trust Fund unveils a budget deficit of about $210 billion!

This budgetary gimmickry must stop. I strongly believe that we will not succeed in balancing the budget until the Congress seriously faces the magnitude of the budget deficit. It is time to make the tough choices.

The primary issue before the committee is whether or not Social Security should continue to be financed on a reserve-building basis or return to a "pay-as-you-go" system. Senator Moynihan's plan to return Social Security to "pay-as-you-go" financing has generated a firestorm reaction from current workers (payroll taxpayers) and senior citizens (beneficiaries). On the one hand, today's workers are attracted to the Moynihan plan

because the tax cut is attractive. On the other hand, today's beneficiaries are deeply concerned that changes in the program could jeopardize their benefits. Our hearing will focus on the short- and long-term solvency and stability of the system.

The Moynihan plan proposes to cut the payroll tax rate by 20 percent over two years. This action would increase the federal budget deficit by more than $55 billion. I have serious concerns about the impact such a revenue loss would have on both the solvency of Social Security and on other federal programs. Our efforts should be focused on eliminating the deficit **where the deficit exists** -- not on eliminating the Social Security surpluses.

The Moynihan proposal would reduce the payroll tax rate from 6.2 percent to 5.1 percent. Under current actuarial assumptions, the Trust Fund will reach 100 percent of annual outgo later this year. I am concerned that without a healthy cushion, the Trust Fund would be vulnerable to economic downturns -- thus, benefits would be jeopardized.

We have heard a lot of rhetoric about the "fairness" of the payroll tax. I have read many statements which discuss the so-called regressivity of the Social Security payroll tax. First, to compare the payroll tax structure to the income tax is like apples to oranges. The fundamental purposes of these taxes are different. Secondly, the Social Security tax is highly progressive on the benefit side of the equation -- lower wage

earners receive proportionally larger benefits than high-wage earners. Additionally, the Earned Income Tax Credit was created specifically to offset the payroll tax for low-income workers.

Senator Moynihan has identified the right issue -- deficit reduction. The problem is that he has suggested the wrong solution.

Social Security should not be a part of the deficit reduction equation. I strongly believe that the Trust Fund should be removed from the Gramm-Rudman targets. In addition, I firmly believe that the recent clamor would have been avoided if Social Security was an independent agency. It seems to me that insulating Social Security from political battles over tax and spend policies would bolster confidence in the system. At the same time, an independent agency would enhance consistency of administration and policy-making for Social Security programs.

When I am asked questions about the Moynihan proposal, most seniors do not understand that the Trust Fund contains only paper IOU's -- there is not a safe deposit box at the Treasury containing Social Security reserves. Social Security reserves are invested in special-issue governmental bonds. As soon as these bonds are purchased the IOU is added to the Social Security account and the assets are spent for other federal programs. I believe that this is a key issue in the current debate.

I have suggested that the Congress look into diversifying the investment of the Trust Fund. While I have full faith in the

ability of the government to honor its bonds today, I wonder how the government will keep its promise down the road when the Social Security Commissioner requests that the Treasury cash one trillion dollars in bonds a year.

Social Security reserves could be invested in various government-backed instruments, like Sallie Mae, Fannie Mae and Freddie Mac. All of these programs issue government-insured bonds. Investment in these agencies would also provide additional opportunities for today's payroll taxpayer -- mortgages for first-time homebuyers and educational loans for students, for example.

Additionally, we should consider investing Social Security reserves in state and municipal bonds. While I understand that there is a potential reduction in interest income, there may be opportunities that would benefit both Social Security and our communities.

Many seniors already have doubts about the system. "Notch babies" feel cheated. Beneficiaries whose benefits are subject to taxation or the earnings limitation experience unfair Social Security policies today. While the Moynihan plan underscores the need to eliminate the federal budget deficit, eliminating the Trust Fund surpluses would only boost the public's doubt about the solvency of the system.

Mr. TAUKE. Mr. Chairman, first let me just observe that I think Senator Moynihan has performed a public service by pointing out to the American people one of the problems that we have now that exists with our budgeting system. He has done a good job in pointing out the right problem. Unfortunately, however, he has the wrong solution to the problem.

The problem is, of course, that we have been masking the deficit that we have at the Federal level, and we have in an unusual sort of way been using Social Security trust fund monies to finance other activities of the Federal Government. However, I don't think that the response to that problem is to throw a monkey-wrench into the Social Security financing system and to call into question the stability of that system.

Clearly, if we adopted the Moynihan proposal, we would have difficulty ensuring the benefits that would be available for the babyboom generation when that generation retires. If my constituents in Iowa who are of babyboom age are reflective of those across the rest of the Nation, I know that many of those citizens already are convinced that they will never benefit from the Social Security program.

I think that if we would adopt the Moynihan proposal, that would only ensure that their convictions would be solidified. Instead, I think what we should be doing is trying to take steps to convince them that the dollars that are in the Social Security trust fund will indeed be available when they are prepared to retire.

I believe that there are three steps that we can take in order to ensure that. One is to move forward with ensuring that Social Security is moved off budget. We took the initial steps in that already. We could move quicker before 1993 to take Social Security off budget, but at least we should ensure that there is no backsliding in that commitment.

Second, we should make Social Security an independent agency. Many Members of the House, the majority, have championed that cause, and we should be able to move that legislation through the process in order to remove the management and operation of the Social Security system from the political process.

Third, we should explore the possibility of providing for more diversification in the investment of Social Security trust funds. There really is no reason why we have to invest all of the Social Security trust funds in U.S. Treasury instruments. They could be invested in State bonds and, in some cases, perhaps, municipal bonds, perhaps Ginny Mae or Fannie Mae. There are a variety of investment opportunities that could be available to Social Security trust funds that would be secure and yet would remove the prospect that the Federal Government would have to refinance massive amounts of debt at the time the babyboomers retire.

Some diversity in the trust fund investment, I think, would give some sense of confidence in the stability of the Social Security trust fund and the availability of those funds when they will be needed to pay retirement benefits for the babyboomers.

If we took these three steps, I think we would solve the problem that Senator Moynihan has outlined, yet at the same time we would not create the problems that adoption of his proposal might create.

The last point I'd make Mr. Chairman is this: having said all of those things, I do think that it would be possible to have a one-time rollback of the 1990 payroll tax hike. Our economic growth has been much greater than we projected when the Social Security legislation was passed in 1983. A one-time rollback would not jeopardize the system. In fact, it would put us in a situation similar to what we had projected we would be in when the legislation was first adopted in 1983.

I hope that we will have good discussion of these issues during the course of this hearing, and I appreciate the opportunity to make a few points and opening comments.

Chairman ROYBAL. Thank you, Mr. Tauke.

I would like to recognize next Mrs. Lloyd.

Mrs. LLOYD. Thank you very much, Mr. Chairman. I would like at this time to yield to Mrs. Oakar because she needs to attend another hearing.

Chairman ROYBAL. Mrs. Oakar is recognized.

## STATEMENT OF REPRESENTATIVE MARY ROSE OAKAR

Ms. OAKAR. Mr. Chairman, thank you, and thank you to my colleagues for letting me go out of order. I apologize.

Mr. Chairman, I just wanted to make a statement, first of all, complimenting you and the distinguished subcommittee chairman for this hearing. I think it is important that the aging committee really focus in on this issue. We have the opportunity to do it, and you have some wonderful witnesses. I apologize for not being able to stay.

I did want to say this: I agree that we should take Social Security off budget the way it was when President Roosevelt signed it into law. We ought to be doing that next year, not 1993. I certainly agree about the independent agency, and then you could really be objective about it.

I wanted to make this reference to the Moynihan plan. As a member of the Pepper Commission, of which Mr. Tauke is also a member, I am going to be making this recommendation when we have our meetings today and Friday.

I think we should take the savings from when you reduce the payroll tax according to the schedule by Senator Moynihan, which would be over a 5-year period about $300 billion, and I think we ought to—make no mistake about it; there is a huge surplus, and it will be even more huge. It has been borrowed from in the past, as we experienced a couple of years ago when Jim Jones and I had to make the amendment to pay back the trust fund money that the Reagan administration had inadvertently borrowed and not told anybody. The fact is that if you took the Moynihan plan and reduced the payroll, over a 5-year period, it would be $300 billion. I don't think we should do that.

I think, however, we should use part of that surplus to cover long-term comprehensive care, which is about a $60 billion proposal, to take the pain off for everyone, not just for older people, but for children, and so on, because you have that surplus. Just as we reformed Social Security and added Medicare in 1965, we can add this portion to it. It won't hurt the trust fund whatsoever, and

you'll be adding a program that the American people need desperately.

I want to compliment you again on having this hearing. It is my idea to take that money, and you, Mr. Chairman, have a fabulous long-term care proposal that you and the late-great Claude Pepper had, and there are other proposals that are very fine as well. That's the way to pay for your proposal. Just take it out of the existing funds and not reduce the payroll tax.

Thank you, Mr. Chairman.

Chairman ROYBAL. Thank you.

Mrs. Lloyd.

## STATEMENT OF REPRESENTATIVE MARILYN LLOYD

Mrs. LLOYD. Thank you very much. Mr. Chairman, I wanted to commend you and my colleague, Mr. Hughes, for calling these hearings. Certainly they are timely, and we want to look to this committee as now the advocate of maintaining the integrity of the Social Security program. I think that we should play a role in finding the solution to the problem. For your leadership, we are so very grateful.

I think it is wise to point out that the future of the Social Security system is an intergenerational issue. First, there is the Social Security old-age survivors disability insurance, OASDI, program for persons who become severely disabled, and widows and their children. It also provides retirement benefits to older Americans, so it is in the best interest of all Americans to protect the integrity of this program that does protect so many people.

Second, although many of the current benefits from Social Security are for older Americans, millions of Americans, many of them baby boomers, of course, will some day receive their rightfully-deserved benefits. We must protect the right to this program for all Americans. We must also ensure that the Medicare hospital insurance trust fund is able to pay for the medical needs of future retirees.

Third, working generations will be affected by any changes in the Social Security payroll tax. We should not be using Social Security payroll taxes to mask or reduce the deficit. This is dishonest and is really not fair to our constituents. Having said that, I think that we should move forward cautiously. I think that a swift change in the Social Security payroll tax could force Gramm-Rudman-Hollings tax cuts to be implemented, and many of us feel that we have cut many of these programs too much already. Hasty changes could also increase the need for increasing revenues, and this disturbs me a great deal.

In conclusion, our deficits have created much of the current dilemma, but we must not rob our future retirees to keep up current spending and retire the national debt. I think you must look at this cautiously. I do commend you for your leadership and providing the forum for looking into the situation.

Thank you, Mr. Chairman.

Chairman ROYBAL. Thank you, Mrs. Lloyd. The Chair recognizes Mr. Porter.

## STATEMENT OF REPRESENTATIVE JOHN EDWARD PORTER

Mr. PORTER. Mr. Chairman, thank you very much. I have been saying for some time that Senator Moynihan has done a great service to our country in pointing out how we are currently misusing the building Social Security reserve. Let me commend both the gentleman from California and the gentleman from New Jersey, our cochairmen, for holding these hearings and highlighting with expert witnesses what the condition of Social Security is for now and projected to be for the future.

I hope that we come out of these hearings with a very strong statement that Social Security is a sound system today, that it is in good shape to provide for senior retirement, not only those already retired, but those prospectively retiring, that it has been a good system for the United States and largely has eliminated senior poverty. If Congress continues to do what it is currently doing regarding the reserve, it will not be a sound system in the 21st century.

I certainly agree with the gentleman from Iowa that taking it off budget is a good step. Making it an independent agency is a good step. It seems to me that the message regarding the Social Security reserve is exactly the one that the lady from Ohio, and I wish she were still here, is sending, and that is that even if Congress takes Social Security off budget and even if it makes it an independent agency, it is very doubtful that Congresses of the future will keep their hands off of the reserve and leave it there for the retirement of the baby boomers around the year 2025 or 2030.

Rather, we will think up ways to spend that reserve, perhaps for long-term care, or perhaps for something else, but it will provide for us a point of departure. With trillions of dollars building up, we will find a way to spend it and make certain that it isn't there for retirement when it is needed.

That is why I believe that simply going to a diversity of investment—and I certainly agree with it—is not enough. The diversity of investment has to be not in the hands of the Government, but in the hands of the people who rely upon that money for their retirement; that is, the American workers of the next century.

I believe very strongly that the only way to protect the reserve and to have it there when it is needed for retirement is to as the reserve builds, refund it into individual Social Security retirement accounts for every American worker who can manage that money and have it on hand at the time that they retire as part of their retirement benefit. If not, Congress will spend it, continue to use it to cover deficits or for new programs, and it simply won't be there when it is needed.

Thank you, Mr. Chairman.

Chairman ROYBAL. Thank you.

Mr. Bilbray.

## STATEMENT OF REPRESENTATIVE JAMES H. BILBRAY

Mr. BILBRAY. Thank you, Mr. Chairman. I want to commend you for calling this hearing on an issue that, over the past 2 months, has roared into the forefront of public debate. The question of taking Social Security off budget is one that impacts all Americans from our senior citizens, who are currently drawing benefits, to

those who are entering the workforce for the first time and will not draw those benefits for 40 or 50 years.

I would like to thank Mrs. Oakar for introducing, along with Mr. Dorgan, H.R. 933, which would exclude the Social Security trust fund receipts from the Federal budget deficit calculation. I am the co-sponsor of this critical legislation that must receive floor consideration this year.

Mr. Chairman, as a member of this committee, I feel that we have a very special obligation to safeguard the integrity of the Social Security fund. On the Senate side, Senator Heinz reportedly has a fail-safe guarantee on a floor vote on this question sometime this year. We need this same forceful advocacy to bring this to a floor vote here in the House. I feel that our committee should take this lead in pushing for this.

Over the past several weeks, I have received many letters from my senior constituents telling me of their disgust with the use of the Social Security surplus to cover up the real budget deficit. These seniors, who paid their hard-earned dollars into Social Security for years and years, certainly do not mince their words when it comes to the topic. Disgusting, dishonest, stealing, deceitful, fraud, and outright theft were all the favorite terms used to describe what we are doing now.

We owe it to them to preserve Social Security's decades old commitment to the older people of this country and to the younger people who are just coming into the system. The only way we can do this is by permanently removing it from the Federal budget.

Chairman ROYBAL. Thank you.

Mr. Shumway.

### STATEMENT OF REPRESENTATIVE NORMAN D. SHUMWAY

Mr. SHUMWAY. Thank you, Mr. Chairman. I have a statement that I ask unanimous consent to be included into the record at this time.

Chairman ROYBAL. Without objection, it will be the order.

[The prepared statement of Mr. Shumway follows:]

STATEMENT OF THE HONORABLE NORMAN D. SHUMWAY

February 28, 1990

As a member of the Select Committee on Aging and the Subcommittee on Retirement Income and Employment, I am pleased to be a able to address the issue of returning Social Security to a "pay-as-you-go" system. I welcome our distinguished guests and look forward to hearing their comments regarding this important matter.

Proposals to reduce taxes are, understandably, almost always popular. What working American doesn't like to hear that a pending measure will result in more money in his or her wallet? Unfortunately, however, not all so-called "tax cut" proposals are what they appear to be.

Regrettably, such is the case with the recent plan to roll back Social Security taxes. Perhaps the most damaging aspect of this proposal is its undermining of our commitment to the nation's senior citizens. In the 70's and 80's, the Social Security System was on the brink of bankruptcy. The present "reserve build-up" tax policy was developed to address that crisis. Most experts agree that a safe reserve ratio is between 100-150 percent of the next year's payments. Currently the ratio is 75 percent. The trust funds will not reach "safe" levels for several more years.

Social Security Trust Fund monies are being manipulated to disguise the staggering size of the federal deficit. Thus, I have long supported the removal of the Social Security Trust Fund from the unified budget. The idea is not new, incidentally. The Trust Fund enjoyed separate status until the Johnson Administration, when it was brought on budget to mask the enormous and unpopular cost of the Vietnam conflict. I have also backed legislative prohibitions on raids of Social Security during times of budget distress.

In an effort to protect both taxpayers and Social Security beneficiaries, Members should work with the Administration to keep the trust funds both solvent, and separate. Returning Social Security to a pay-as-you-go system is not the answer. Let us begin to address this issue in the best interest of our senior citizens. Removing Social Security from the unified budget is the first step.

Mr. SHUMWAY. Mr. Chairman, I'd like to commend you for convening this hearing. It is certainly a very appropriate topic, and I think it is important that the committee, as well as the subcommittee, stake out its jurisdiction at this early point in the debate on this subject because obviously we have a very key role to play as members of the Aging Committee.

Over the years that I have been privileged to serve on this committee, I have seen the role of the committee actually develop and to be one of a protector of the livelihood, and the lives for that matter, of the Nation's senior citizens. I think certainly in this regard we have a role to demonstrate that we are not going to allow proposals to tamper with the Social Security trust funds and to somehow undermine the commitment that we have made to the Nation's senior citizens. There is no doubt about the fact that those trust fund monies have been manipulated to disguise the staggering size of the Federal deficit. I think in that regard we all must move toward removal of the trust funds from the unified budget.

To that end, Mr. Chairman, I think it is appropriate that we meet today. It is appropriate that we hear from these expert witnesses. I look forward to their testimony. Again, thank you for convening this hearing.

Chairman ROYBAL. Thank you. Mr. Saxton.

## STATEMENT OF REPRESENTATIVE JIM SAXTON

Mr. SAXTON. Mr. Chairman, thank you. I just have a very brief statement to make. I have spent a lot of time dealing with this issue since Mr. Moynihan was successful in raising it a while back. It seems pretty obvious to me that, from what we've discussed between members, what we've read in the press, what our constituents have told us, and what I've heard echoed here this morning, to use the Social Security trust fund to hide a significant part of the deficit is flat out wrong.

However, at the same time, American people have been told since 1983 that we were developing a long-range plan to protect the Social Security system. So if we are going to begin to tinker with that system, if we are going to begin to make changes to the system that reduce the amount of confidence or the level of confidence of the American people, including and particularly older Americans and people who are currently Social Security beneficiaries and those who may look forward in the near future to becoming Social Security beneficiaries, and if the level of confidence in the system is reduced, I think we are doing a great disservice to the American public and to the Social Security system itself.

To take Social Security off budget, to create a separate trust fund for Social Security, I believe, are positive steps. At the same time, if we go beyond that, we want to be very, very careful of what we recommend. Thank you, Mr. Chairman.

Chairman ROYBAL. Thank you very much.

At this time I would like to submit for the record the prepared statements of representatives Bill Richardson, Jerry Costello, Ralph Regula, and Cliff Stearns. Hearing no objections, so ordered.

[The prepared statements of representatives Richardson, Costello, Regula and Stearns follow:]

Statement by Congressman Bill Richardson,
Member, Select Committee on Aging

Joint Hearing of the House Select Committee on Aging
and the Subcommittee on Retirement Income and Employment

February 28, 1990

"Returning Social Security to Pay-As-You-Go Financing:
Impact on Benefits and the Federal Budget Deficit"

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Thank you Mr. Chairman. I commend you for holding hearings on the controversial proposal to cut the Social Security tax and return Social Security to a pay-as-you-go system.

Senator Moynihan's proposal has punctured the veil surrounding the Social Security system. My constituents are angry that they have been misled and that there is no "trust" in the trust fund.

The definition of security is "something given to ensure the fulfillment of an obligation". The Federal government has the responsibility of making good on its obligation to future Social Security recipients. By using the Social Security surpluses to regressively finance deficits in the operating budget, the federal government has instead replaced that security with an overwhelming burden for future generations. I feel it is essential that we develop a Social Security finance policy that will restore public confidence in this system.

I believe this hearing will give us a better understanding of how the current system works, as well as the implications of possible changes. I look forward to hearing from our distinguished panelists.

OPENING STATEMENT BY U.S. REP. JERRY COSTELLO, ILLINOIS
HOUSE SELECT COMMITTEE ON AGING
SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT
FEBRUARY 28, 1990
"RETURNING SOCIAL SECURITY TO PAY-AS-YOU GO FINANCING: IMPACT ON BENEFITS AND THE FEDERAL BUDGET DEFICIT"

I am glad that Senator Moynihan introduced legislation to cut the Social Security tax because it has sparked debate on the way the Social Security System is financed. Today's hearing will focus on the impact of returning Social Security to a pay-as-you go program and I would like to take this opportunity to thank you, Mr. Chairman, for today's timely hearing.

Currently, the Social Security program is running a surplus which is intended to pay for the retirement of the large "baby boom" generation. It is of vital importance that Social Security remain sound to pay for the retirement of millions of citizens who have paid in over the years. However, the extra funds in the Social Security Trust have been used by Congress and the Administration to mask the true size of the deficit.

Our witnesses include many experts that will discuss the role of the Social Security Trust Fund and its relationship to the deficit, as well as the short and long-term economic effects of cutting the Social Security tax.

I look forward to hearing today's testimony and I would like to thank you again, Mr. Chairman, for conducting this hearing.

OPENING STATMENT OF THE HONORABLE RALPH REGULA, R-OHIO
SELECT COMMITTEE ON AGING - FEBRUARY 28, 1990

Mr. Chairman:

Several bills have been introduced which would eliminate the large and growing Social Security (OASDI) surpluses. Most of these proposals would repeal the 1990 increase in the payroll tax immediately and return the OASDI system to "pay-as-you-go" financing in 1991.

Under current law, the Social Security Trust Funds are increasing over $110 million per day and rising. In fact, by the year 2000 the surplus will grow to $1.4 trillion.

This surplus creates both threats and opportunities for our nation's economic health. Our actions must be measured and carefully considered to avoid a rash and temporary solution based solely on political aims.

As unbelievable as it may sound, maintaining the status quo will most certainly eliminate both the federal deficit and public debt within the next two decades. Now Social Security revenues are required to be deposited with the Treasury in the form of bonds. Every week millions in U.S. debt matures and must be paid off from tax revenues or more credit. These revenues are used to meet those demands. But reductions under Gramm-Rudman will bring our present deficit path to a zero deficit by 1993. When that happens, the revenue from the payroll tax will no longer be needed to finance current credit demands of the government and will be sufficient to begin retiring the public debt by 1994. By 2010 the reserve

is estimated to be over $4.5 trill. which would easily bring us to zero national debt.

The danger in permitting these funds to be used in this manner is that by 2020 the "baby boomers" will enter into retirement placing a significant strain upon the system. The government will find itself being required to pay back the original debt in premium payments based on a surplus that exists only in the form of credit notes.

Discontinuing the current use of the surplus would also be a sure method for increasing savings and investments. A recent study of national savings rates placed the U.S. at 20th in the world, followed by Iceland. Allowing these funds to be redirected into private, as well as public investments, would make America awash in capital by the next decade. Legislation has been introduced in the Senate which would allow decreases in the payroll tax to be directed into personal saving accounts. Under my direction, the Subcommittee on Health and Long-Term Care is currently considering proposals for redirecting portions of the payroll tax into private saving devices, particularly IRAs. I expect our findings will add to the debate of this important issue.

I look forward to the comments of our distinguished panel of witnesses on this very important matter.

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OPENING STATEMENT
HON. CLIFF STEARNS

HOUSE SELECT COMMITTEE ON AGING

Returning SS to pay as you go financing: Impact on benefits and the Federal budget deficit.

28 FEBRUARY 90

Mr. Chairman, thank you for this opportunity to speak. I am very interested in the testimony from today's hearing. Congress needs to seriously explore the budget impact of possibly returning the Social Security system to pay-you-go financing. While I have reservations about returning to such a financing system, it certainly is worthy of debate.

Social Security is a subject of critical importance to every American, young and old, rich and poor. It is far too important to be hidden in a politically unmentionable category. It needs to be put on the table for discussion and debate.

Hearings, like this one today are crucial to the future of the Social Security system. I compliment Chairman Roybal, and Chairman Hughes for their efforts in arranging this

hearing. There are too many who would much prefer keeping this subject under the rug.

Let me also take this opportunity to express my concern about using the Social Security surplus to give an artificially low estimate of the national debt. I believe we need a realistic snapshot of our fiscal position, and using social security funds which are already obligated creates an inaccurate picture.

Thank you very much Mr. Chairman, I look forward to today's testimony

Chairman ROYBAL. The first panel will be made up of Mr. Robert D. Reischauer, who is the Director of the Congressional Budget Office and Mr. Louis D. Enoff, who is the deputy commissioner for programs for the Social Security Administration.

We are now ready to hear testimony that will be used by this full committee to make recommendations to their authorizing and appropriating committees of the Congress of the United States.

The Chair now recognizes Mr. Robert D. Reischauer. We ask you, sir, to proceed in any manner that you may desire.

## STATEMENTS OF ROBERT D. REISCHAUER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE AND LOUIS D. ENOFF, DEPUTY COMMISSIONER FOR PROGRAMS, SOCIAL SECURITY ADMINISTRATION

### STATEMENT OF ROBERT D. REISCHAUER

Mr. REISCHAUER. Thank you, Mr. Chairman. It is a pleasure to be here and have the opportunity to take part in this important debate. I will submit my prepared statement for the record and focus my remarks this morning on three issues. The first of these is how current budget policy can enhance the Nation's ability and willingness to support the increased costs of Social Security benefits in the future.

Chairman ROYBAL. May I say at this point that your entire statement will appear in the record, and then followed by your remarks.

Mr. REISCHAUER. Thank you. The second issue that I will address is the likely economic and distributional effects of some of the proposals to reduce the payroll tax. The third issue is the choice between pay-as-you-go and partial reserve financing of Social Security.

When the baby boom generation begins retiring, the Federal Government will have to transfer more resources to retirees. To do this, the government must gain command over resources that will be available at that time. It will do this either by raising taxes or by reducing other forms of government spending. The Nation will be better able to bear the burden of these increased taxes or the reduced government spending if overall GNP and overall national wealth are as large as possible.

The primary way the government can augment the size of the economy in the future is to take actions today that add to national saving. Increased national saving will increase the productivity of the economy and the amount of available income that can be shared between future workers and future retirees. The most straightforward way for the government to increase national saving is to reduce the Federal deficit.

The reallocation of resources to retirees would be less of a strain on the working population if GNP were larger. The reason for this is not that the share of GNP required for Social Security benefits will be smaller if growth is faster and the economy is larger. The share of GNP that goes to retirees increases just about as rapidly as GNP grows when the economy expands at a faster rate because the higher wages associated with faster growth translate fairly quickly into higher Social Security benefits. Presumably, a society

with more income is better able to devote a fixed share of that income to retirees than one that is not so well off.

Reduced budget deficits may increase the Nation's willingness, as well as its ability, to finance the rising costs of retirement benefits because lower deficits now will reduce the share of future tax revenues that will have to be devoted to government interest payments. This will leave more government resources for purposes that directly benefit future citizens and future taxpayers.

As a result, citizens may be more willing to reallocate resources to retirees than they would if a significant portion of their tax dollar were eaten up paying the debt service costs associated with public services that were consumed but not paid for by earlier generations.

Let me now turn to the likely economic repercussions of reducing the payroll tax, along the lines proposed by Senator Moynihan. If this were done without offsetting actions, the baseline deficit would increase by about $40 billion in 1991 and by greater amounts in later years. Because the economy is now operating close to its full capacity a significant cut in the payroll tax could increase total demand for goods beyond the economy's capacity to produce them. Potentially, this could lead to increases in both inflation and in the Nation's trade deficit.

The Federal Reserve would probably try to head off any extra inflationary pressures by raising interest rates. Higher interest rates in turn could reduce investment and complicate the problems faced by heavily indebted domestic corporations and by the thrift industry.

Over the longer term, significant increases in the Federal deficit could exacerbate current economic problems, such as slow growth and productivity and our Nation's faltering international competitiveness.

A significant reduction in payroll taxes could have a notable impact on the distribution of tax burdens. The effects could be neutral, progressive, or regressive. Much would depend on whether the payroll tax cut was offset by other tax increases or other spending cuts and, if it were, the nature of those offsets. Figures 1, 2, and 3 in my prepared statement, which can be found on pages 19, 21, and 23, show the changes in tax burdens and after-tax incomes that would result from a simple $50 billion reduction in payroll taxes and from a $50 billion reduction in payroll taxes that was offset by either a 10 percent income tax surcharge or a value-added tax of about 3 percent. These tables show how, depending on what assumptions you make about offsets, you can have a more progressive or a less progressive tax system in the long run.

Let me close by saying a few words about the important issue of how the Nation should finance Social Security benefits. Should we set payroll taxes so that annual revenues approximately equal outlays, or should we set rates so as to build up reserves? There is no right answer to this question.

Two principal arguments can be made for building up large reserves as we are now doing. One is based on considerations of intergenerational equity and the other on explicitly political concerns.

There would be no equity issue if each succeeding generation were approximately the same size. The payroll tax rate for each

generation of workers under a pay-as-you-go system of financing would be roughly constant. But this is not the situation posed by the baby boom generation, which is a good deal larger than the preceding generations. Under a pay-as-you-go system of financing, the baby boom population would be able to pay a low payroll tax rate while working because there would be so many of them paying for a relatively small number of current retirees. But when the baby boomers retired, its successors would have to bear much higher payroll tax rates.

Given this demographic situation, some have argued that the current system of partial advance funding offers a method of ensuring that the baby boom generation bears its fair share of the burden and does not stick succeeding generations with a large unpaid bill.

The second argument for accumulating a large reserve rests on a belief that the only way the electorate and the American political system will tolerate the large overall government surpluses that would enhance economic growth and boost future living standards is to accumulate these surpluses in the Social Security accounts. It would be politically impossible, they argue, to run surpluses in a non-Social Security portion of the budget. The American people have consistently endorsed the notion of a balance in the non-Social Security portion of the budget, and they have long understood the concept of saving for retirement.

Those who advocate pay-as-you-go financing do not accept the intergenerational equity argument that I have just laid out because they consider that it is far too narrow. They feel that concerns of intergenerational equity should be based on a broader comparison of relative economic positions of the various generations. Such a comparison would consider the possibility that demographic pressures have reduced the real wages of the baby boomers, while the next generation should experience faster wage growth because of slower growth in the labor force. So their incomes, in a sense, will be much larger, and they will be better able to pay higher taxes.

Furthermore, the baby boomers may not benefit as much as previous generations have when they liquidate their assets upon retirement. With so many of them selling their homes, their stocks, their bonds, and their assets in their thrift savings plan, the prices of these assets could be depressed.

Furthermore, pay-as-you-go financing has the advantage of allowing for a greater degree of flexibility. If we hold to a partially funded system with large reserves, there will be little reason to periodically reexamine the program.

While capricious, short-run fiddling should be opposed by all of us, periodic reexamination makes sense in the light of changes that we all know will be occurring in dimensions of our society such as marital arrangements, participation in the labor force, immigration, private pension plans structures, life expectancies, the health status of the aged, and the changing physical demands of work. All of these changes should have some bearing on how we structure Social Security, both now and in the future.

Let me conclude with three observations. First, the issue of Social Security financing should not be regarded as settled by the 1983 Social Security amendments. The issues that I have raised

today were not debated in full at that time, and they deserve to be debated before the issue can be considered resolved.

Second, it is clear that no substantial policy change in Social Security can be meaningfully decided in isolation. I have already pointed out the links between Social Security and overall national saving and the Federal deficit. I would also add the obvious link with health care programs for the aged. It is unthinkable to change the payroll tax based on considerations of retirement benefits alone, when we know that the Medicare trust fund will be in trouble probably before the baby boomers begin to retire.

Third, and finally, since the trust fund buildup in the next couple of years is needed just to offer protection against a future recession, there is little need to resolve the Social Security financing issue right away. A suficient contingency reserve will not be achieved until 1992 or 1993. Because of that, there is really no reason to settle this issue this year. A couple of years remain in which to debate and resolve this issue which, is of tremendous importance to the American people and to our society.

Thank you.

[The prepared statement of Mr. Reischauer and answers to written questions submitted by Chairmen Roybal and Hughes and Representative Marylin Lloyd follow:]

Statement of
Robert D. Reischauer
Director
Congressional Budget Office

before the
Subcommittee on Retirement Income
and Employment
Select Committee on Aging
U.S. House of Representatives

February 28, 1990

**NOTICE**

This statement is not available for public release until it is delivered at 10:00 a.m. (EST), Wednesday, February 28, 1990.

Mr. Chairman, I am pleased to be here today to discuss the budgetary and economic implications of proposals to exempt Social Security finances from the Balanced Budget Act's deficit calculations and of S. 2016, Senator Moynihan's bill to return Social Security to a pay-as-you-go-system. This statement tries to clarify a number of the issues underlying what has been a spirited, but somewhat confused, debate about the merits of alternative approaches to financing Social Security. It examines the following four issues:

- How current budget policy can enhance the nation's ability and willingness to support the increased costs of future Social Security benefits;

- The likely effects of S. 2016 on the economy;

- The impact of payroll tax reductions on the distribution of after-tax incomes of families; and

- The choice between pay-as-you-go and partial reserve financing of Social Security.

PAYING FOR THE BABY BOOM'S RETIREMENT

In the United States today, there are 3.3 members of the labor force for every retiree. This relationship remains roughly constant for the next 20 years. Then, between 2010 and 2030, the ratio declines sharply to about two workers for each retiree, and declines slightly thereafter (under the Social Security actuaries' intermediate assumptions). The problem, then, is how the government can help the nation adjust to a rapidly aging population, especially in the transition period starting 20 years from now when the baby boom begins to retire.

Just as the baby boomers caused sharp changes in our schools in the 1950s, in our colleges in the 1960s, and in the labor and housing markets over the last 20 years, it seems guaranteed that they will bring about important changes when they retire. Assets that have been built up in corporate pension funds and, in all likelihood, in home equity will have to be liquidated to support the consumption needs of the retirees. Barring a medical revolution, demands on the health sector and on long-term care facilities will sharply accelerate. The growing pressure on slow-growing U.S. productive capacity could spill over to heightened demands for imports. Major segments of the labor market will tighten as waves of

older workers leave the labor force, replaced by the less experienced grandchildren of the baby boom.

The real challenges to the economy in the next century extend well beyond the Social Security system. I offer these observations as a backdrop for my discussion of Social Security to emphasize that we are talking about how society will extract a sharply increasing share of the fruits of production in the future and allocate them to an enlarged retired population. Federal provision of Social Security is only a part of this landscape and, in some ways, it is one of the most tractable.

## Social Security and Saving

When the baby-boom generation begins retiring, the federal government will have to transfer more resources to the retirees to whom it has made a promise of payments. To do this, the government must gain command over the resources then available. Without reducing other spending, there is essentially only one way to do this: by enhanced revenues, or "higher taxes" as we used to call them. This need is inescapable: it follows from the discrete demographic upturn in retirees and the

society has made to them. But how does government activity today have a bearing on the prospects for a transfer of resources 20 years ahead?

The only links between today's policies and the payment of tomorrow's retirement benefits are the effects of our current actions on the future size of the economy. The nation will be better able to bear increased taxes (or, a shift in the pattern of public spending) if overall gross national product (GNP) and national wealth--held in both domestic and foreign assets--are as large as possible.

The primary way for the government to enlarge the size of the economy in the future is to take actions that add to national saving--in other words, to reduce its deficit. Reducing the federal deficit will increase national saving during the 20 or so years that remain before the baby boom begins to retire. Added saving will increase the productivity of the economy and the amount of income that will be available to be shared between future workers and retirees. These improvements should make the reallocation of resources to retirees less of a strain on the working population of that time.

The reason for this amelioration is not that the share of GNP required for Social Security benefits will be drastically reduced if GNP growth is spurred. The share will be only a bit smaller because the same forces that work to increase the productivity of the economy will also generate higher wages, which in turn will result in increased Social Security benefits. As a result, the part of GNP that goes to Social Security beneficiaries will grow almost as fast as GNP as a whole will. But presumably a society with more income is better able to devote a fixed share of its resources to retirement benefits than one that is not so well off. Moreover, without question, higher wealth would make it easier to finance Medicare benefits, which are not linked to the pace of GNP growth.

This argument suggests that reduced budget deficits will increase the nation's future ability to finance retirement benefits. But they may also affect its willingness to do so because lower deficits now will reduce the share of future tax revenues that will go to pay the federal government's interest costs. If deficits are cut, the federal government's interest payments in the next century will be reduced. Consequently, more government resources could be devoted to purposes that directly benefit future citizens and taxpayers. Hence,

they may be more willing to reallocate resources to retirees than would a population that had to devote a significant portion of its tax payments to paying the debt-service costs of government services that had been consumed--but not paid for--by previous generations.

## Appropriate and Inappropriate Uses of Social Security Reserves

Reducing the deficit means exactly what it says: reducing government spending or raising taxes. But not all spending and not all kinds of taxes have the same implications for national saving. It would not help national growth to gut public investment or to raise taxes in a way that discourages productive private investment. This qualification aside, the total federal deficit was designed to measure just the right thing: when it increases, the government is absorbing more saving; when it is cut, the government is absorbing less saving.

Nonetheless, this concept of the total deficit has recently been called into question by those who feel that including Social Security surpluses in it deludes the body politic. They speak of Social Security "masking the deficit" or hiding the "true deficit." They argue

that sharper reductions in the federal deficit would have been more likely had the Social Security surplus not helped to obscure the lack of change in the deficit in all other federal accounts combined since 1983. They contend that the practice of investing Social Security reserves in Treasury securities is an illegitimate use of these resources to finance other activities of government.

This line of argument is faulty on several grounds. First, we do not know how fast the deficit in the rest of the federal budget would have declined without the growing Social Security surpluses of the 1980s. When the Balanced Budget Act's targets for the deficit were set, it was well known that Social Security would generate large surpluses. Had those surpluses not been a prospect, the targets in all likelihood would have been set higher. If they had not been, the gap between the targets and the actual deficits probably would have been commensurately larger. The reason the deficit has not been cut by more is not that the deficit targets were insufficiently ambitious. Rather it was that the steps needed to bring the deficit down were too painful and that there existed little leadership or public support for such actions.

Moreover, it is difficult to make a case that the Social Security surplus has been hiding the deficit in the remainder of the budget since the Balanced Budget Act was passed in 1985. The Balanced Budget Act took Social Security off-budget precisely to highlight its importance to the overall deficit. Both CBO and OMB began explicitly showing figures on the Social Security surplus and the deficit in the rest of the budget in early 1986, and they have continued to do so ever since. The budget resolutions adopted by the Congress for the fiscal years following 1986 clearly indicated the size of the expected Social Security surplus and the projected deficit in the balance of the budget. If policymakers have chosen not to reduce the deficit in the non-Social Security budget more during that period, it has not been because that deficit has been hidden from view.

In addition, the Social Security surplus is not an accurate measure of Social Security's offsetting effects on federal borrowing. A significant component of the surplus is made up of transfers from other federal accounts. These transfers work to increase the apparent size of both the Social Security surplus and the non-Social Security deficit, as is shown in Table 1. In other words, the amount of surplus that the Social Security trust fund is generating independently of the

TABLE 1. SOCIAL SECURITY INCOME AND OUTLAYS
(By fiscal year, in billions of dollars)

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|
| **Income** | | | | | | |
| Income from Public: | | | | | | |
| Off-Budget Revenues | 288 | 309 | 330 | 352 | 376 | 401 |
| Intrabudgetary Income: | | | | | | |
| Interest | 16 | 22 | 27 | 34 | 42 | 50 |
| Employer share of employee retirement | 6 | 6 | 7 | 7 | 8 | 9 |
| Taxes on benefits | 4 | 5 | 5 | 6 | 6 | 7 |
| Other | 2 | a | a | a | a | a |
| Subtotal | 28 | 32 | 39 | 47 | 56 | 66 |
| Total Income | 316 | 341 | 369 | 399 | 432 | 467 |
| **Outlays** | | | | | | |
| Payments to Public: | | | | | | |
| Benefit payments | 243 | 260 | 277 | 294 | 312 | 331 |
| Administrative expenses | 2 | 2 | 2 | 2 | 3 | 3 |
| Subtotal | 245 | 262 | 279 | 297 | 315 | 334 |
| Intrabudgetary Payments[b] | 4 | 4 | 5 | 5 | 5 | 5 |
| Total Outlays | 250 | 267 | 284 | 301 | 320 | 339 |
| **Surplus** | | | | | | |
| As Conventionally Measured | | 74 | 85 | 98 | 112 | 128 |
| Less: Intrabudgetary Transfers (Net) | -24 | -28 | -35 | -42 | -51 | -61 |
| Surplus Excluding Intrabudgetary Transfers | 42 | 47 | 51 | 56 | 61 | 67 |

SOURCE: Congressional Budget Office.

a. Less than $500 million.

b. Primarily interest paid to Treasury on normalized tax transfers and payment to Railroad Retirement.

rest of the government is less than it appears and, similarly, the size of the deficit that the non-Social Security budget is running independently of Social Security is less than it appears.

Finally, the notion that lending Social Security reserves to the Treasury represents a misuse of those funds reflects a misunderstanding of earmarked revenues in the federal budget. First, Social Security contributions eventually will be used for Social Security benefits; every dollar coming in results in budget authority for the Social Security trust fund. Second, the U.S. Treasury always uses whatever cash is on hand to make payments before borrowing. Thus, when any fund shows a surplus, the excess cash is used to meet the Treasury's current obligations, whether the excess cash comes from Social Security contributions, gasoline taxes, or taxes on recreational fishing gear. In that sense, the money is used for nonearmarked purposes. There is no sensible alternative to this procedure: after all, why should the Treasury borrow funds when it already has them?

Third, strictly speaking, the only way to avoid devoting earmarked receipts to other purposes is for the Treasury to have no need to spend any excess funds

derived from the earmarked accounts. This means not only balancing the overall budget, but running a surplus. In other words, what some consider to be ill-advised uses of Social Security reserves will end only when the government eliminates the deficit and contributes to national saving rather than using it up. But the case for the government's budget to be in surplus surely should be argued on the merits of its effects on national saving, not on a desire to avoid the appearance of misusing earmarked funds.

So far, I have tried to show why the currently fashionable view that only the non-Social Security deficit can be viewed as the "true" federal deficit is incorrect. The best measure of the extent to which the federal government absorbs private saving remains the deficit of the whole federal government-(other than for federal investments), including Social Security.

## ECONOMIC IMPLICATIONS OF S. 2016

On January 23, Senator Daniel P. Moynihan introduced S. 2016. In the subsequent debate, the effects of this bill on the economy and on the distribution of income have played a major role. What would enactment of S. 2016 do

to the economy? If the measure were enacted without offsetting reductions in the deficit, it could have adverse economic effects over both the short and long run. CBO has estimated that S. 2016 would increase the $138 billion baseline deficit by $40 billion in 1991 and by greater amounts in later years (see Table 2). This figure is slightly lower than other estimates, partly because it incorporates an assumption that wage rates would increase somewhat in response to the reduction in the employers' payroll tax rate, thereby raising other tax revenues enough to offset a part of the direct revenue loss.

Short-Run Effects

Because the economy is operating close to its full capacity now, a significant reduction in payroll tax rates without offsetting deficit reductions elsewhere could harm the economy's performance over the next several years. A significant payroll tax cut could increase total demand for goods beyond the economy's capacity to produce them, leading potentially to increases in both inflation and the trade deficit. The Federal Reserve would be likely to try to head off such extra inflation by raising interest rates, which are

TABLE 2. BUDGETARY EFFECT OF S. 2016
(By fiscal year, in billions of dollars)

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|
| **Off-Budget (Social Security)** | | | | | | |
| Baseline Surplus | 66 | 74 | 85 | 98 | 112 | 128 |
| Changes: | | | | | | |
| Payroll taxes | -5 | -42 | -58 | -62 | -67 | -71 |
| Interest | a | -2 | -6 | -11 | -17 | -23 |
| Total changes | -5 | -45 | -64 | -74 | -84 | -94 |
| Surplus, S. 2016 | 61 | 30 | 21 | 24 | 29 | 34 |
| **Off-Budget (All Other)** | | | | | | |
| Baseline Deficit | -204 | -212 | -221 | -239 | -242 | -246 |
| Changes: | | | | | | |
| Income tax offset[b] | 1 | 4 | 6 | 6 | 7 | 7 |
| FERS offset[c] | a | a | a | 1 | 1 | 1 |
| Interest | a | a | 1 | 1 | 2 | 2 |
| Total changes | 1 | 5 | 7 | 8 | 9 | 10 |
| Deficit, S. 2016 | -204 | -208 | -214 | -231 | -233 | -235 |
| **Total Budget** | | | | | | |
| Baseline Deficit | -138 | -138 | -135 | -141 | -130 | -118 |
| Changes: | | | | | | |
| Payroll taxes | -5 | -42 | -58 | -62 | -67 | -71 |
| Income tax offset[b] | 1 | 4 | 6 | 6 | 7 | 7 |
| FERS offset[c] | a | a | a | 1 | 1 | 1 |
| Interest | a | -2 | -6 | -10 | -10 | -20 |
| Total changes | -4 | -40 | -58 | -66 | -75 | -84 |
| Deficit, S. 2016 | -143 | -178 | -193 | -207 | -204 | -202 |

SOURCE: Congressional Budget Office.

a. Less than $500 million.

b. Assuming that nominal GNP is held constant, a reduction in Social Security taxes would increase income and, therefore, increase income taxes. These estimates are net of increased income tax revenues.

c. A reduction in Social Security taxes would automatically increase the tax rate for the Federal Employees Retirement System.

already quite high by historical standards when adjusted for inflation. These higher rates could further reduce investment and complicate many problem areas, such as the cash-flow problems of developing countries and domestic corporations that are already heavily indebted. In addition, they could make resolving the currently formidable problems of the thrift industry even more difficult.

Long-Term Effects

Over the long run, significant increases in the federal deficit could exacerbate several current economic problems, such as low net investment, slow growth in productivity, and faltering competitiveness in international markets. A further increase in the federal deficit from a cut in taxes would divert more of our limited saving away from investment (including research and development) that could increase our productivity, competitiveness, and living standards. Competitiveness would also suffer if the higher interest rates that would accompany lower saving caused the dollar to appreciate on foreign exchange markets, making American goods more expensive and foreign goods cheaper.

Some analysts have argued that reduced payroll tax rates for employers could help improve the competitiveness of American goods by reducing this component of labor costs. This outcome, though, seems unlikely. Most studies of the payroll tax conclude that the employers' share ultimately has little effect on employers' costs because it is absorbed by workers in the form of lower wages than they would otherwise get. This implies that a reduction in employers' rates would be met with offsetting increases in wage rates or additional fringe benefits. As a result, there might be little improvement in the costs of employers, and therefore in the competitiveness of the goods that they produce.

## Effects on the Income Distribution

A major impetus behind the current effort to reduce the payroll tax is the recent trends evident in the distribution of income and the progressivity of the tax system. Between 1980 and 1990, average adjusted real family income--family income divided by the appropriate poverty threshold--of the top fifth of families rose by 31.7 percent, while the average income of families in the bottom four income quintiles either rose much more slowly or actually declined as in the case of the bottom income

quintile (see Table 3). During this same period, the total federal effective tax rate of families in the top two income quintiles declined, while in the bottom three quintiles it rose (see Table 4). Although federal taxes in 1990 are more progressive than they were in 1985, they are less progressive than they were in either 1977 or 1980.

The increased reliance on social insurance payroll taxes is the major explanation for the reduced progressivity of the tax system. Lowering payroll tax rates over the next 25 years with no offsetting changes

TABLE 3. AVERAGE ADJUSTED FAMILY INCOME
(Income expressed as multiples of the poverty thresholds)

| Quintile[a] | 1977 | 1980 | 1985 | 1990[b] | Percentage Change 1977-1990 | Percentage Change 1980-1990 | Percentage Change 1985-1990 |
|---|---|---|---|---|---|---|---|
| Lowest[c] | 0.95 | 0.86 | 0.80 | 0.84 | -11.8 | -3.2 | 4.5 |
| Second | 2.06 | 1.92 | 1.86 | 2.00 | -2.7 | 4.3 | 7.3 |
| Third | 3.09 | 2.93 | 2.96 | 3.18 | 2.8 | 8.4 | 7.2 |
| Fourth | 4.34 | 4.17 | 4.35 | 4.70 | 8.4 | 12.6 | 8.0 |
| Highest | 8.70 | 8.61 | 9.83 | 11.34 | 30.3 | 31.7 | 15.3 |
| Top 10 percent | 11.46 | 11.39 | 13.39 | 15.76 | 37.6 | 38.4 | 17.7 |
| Top 5 percent | 15.22 | 15.42 | 18.65 | 22.52 | 48.0 | 46.1 | 20.8 |
| Total[d] | 3.84 | 3.69 | 3.96 | 4.39 | 14.3 | 18.7 | 10.8 |

SOURCE: Congressional Budget Office Tax Simulation Model.

a. Ranked by size of adjusted family income.
b. Projected based on Internal Revenue Service and Census Bureau data, using CBO economic forecast.
c. Excludes families with zero or negative incomes.
d. Includes families with zero or negative incomes not shown separately.

in other federal spending or taxes would ameliorate this situation somewhat. If the Balanced Budget Act deficit targets were adhered to, however, offsetting changes in spending or taxes would be required. Whether the end result would be to make federal taxes more or less progressive or the distribution of income more or less equal would depend on the nature of these offsetting measures. Among the many possible offsets to the deficit-increasing effects of a payroll tax cut, I will discuss two in my statement today--an increase in income

TABLE 4. TOTAL FEDERAL EFFECTIVE TAX RATES

| Quintile[a] | 1977 | 1980 | 1985 | 1990[b] | Percentage Change 1977-1990 | Percentage Change 1980-1990 | Percentage Change 1985-1990 |
|---|---|---|---|---|---|---|---|
| Lowest[c] | 9.5 | 8.4 | 10.6 | 9.7 | 2.6 | 16.1 | -8.1 |
| Second | 15.6 | 15.7 | 16.1 | 16.7 | 6.6 | 6.0 | 3.8 |
| Third | 19.6 | 20.0 | 19.3 | 20.3 | 3.6 | 1.2 | 5.1 |
| Fourth | 21.9 | 23.0 | 21.7 | 22.5 | 2.6 | -2.2 | 3.6 |
| Highest | 27.1 | 27.3 | 24.0 | 25.8 | -4.6 | -5.5 | 7.4 |
| Top 10 percent | 28.7 | 28.4 | 24.4 | 26.4 | -8.1 | -7.3 | 8.2 |
| Top 5 percent | 30.5 | 29.5 | 24.5 | 26.7 | -12.5 | -9.5 | 9.0 |
| Total[d] | 22.8 | 23.3 | 21.7 | 23.0 | 1.2 | -1.0 | 5.9 |

SOURCE: Congressional Budget Office Tax Simulation Model.

a. Ranked by size of adjusted family income.

b. Projected based on Internal Revenue Service and Census Bureau data, using CBO economic forecast.

c. Excludes families with zero or negative incomes.

d. Includes families with zero or negative incomes not shown separately.

tax rates and the imposition of a federal value-added (sales) tax (VAT).

## Effects on the Distribution of After-Tax Incomes

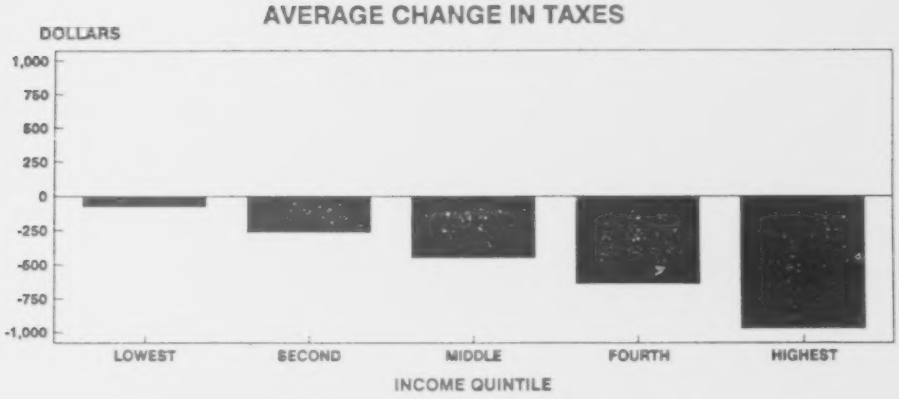
Lowering payroll taxes would not appreciably increase the relative share of after-tax income received by low-income families. If payroll taxes were reduced by $50 billion and not offset by increases in other taxes, the tax burdens--federal taxes as a percent of pre-tax incomes--on lower-income families would be reduced relatively more than those of middle- and upper-income families (see Figure 1). The payroll tax reductions would raise the after-tax incomes of families in the lowest income quintile by 1.1 percent and the after-tax income of families in the highest income quintile by 1.2 percent. These results reflect the assumption that the employers' share of payroll taxes is ultimately paid by workers in the form of lower wages.

## Offsetting Increases in Income-Tax Rates

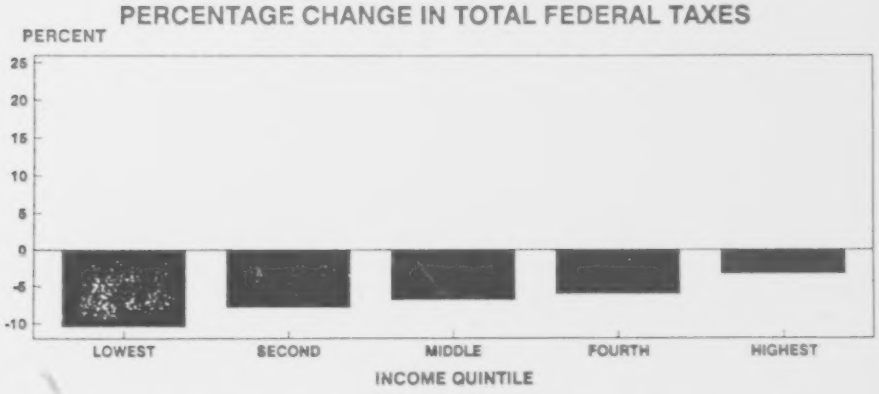
If the $50 billion in lost revenue from the payroll tax were replaced through a surcharge of about 10 percent on

# FIGURE 1. S. 2016

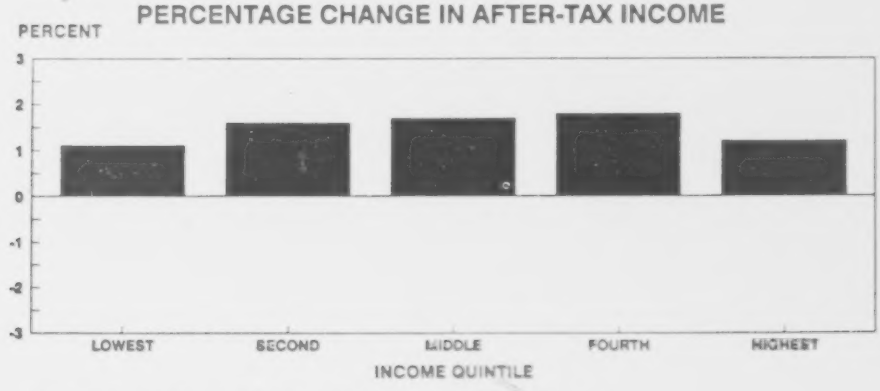
## AVERAGE CHANGE IN TAXES




## PERCENTAGE CHANGE IN TOTAL FEDERAL TAXES




## PERCENTAGE CHANGE IN AFTER-TAX INCOME




SOURCE: CONGRESSIONAL BUDGET OFFICE TAX SIMULATION MODELS.

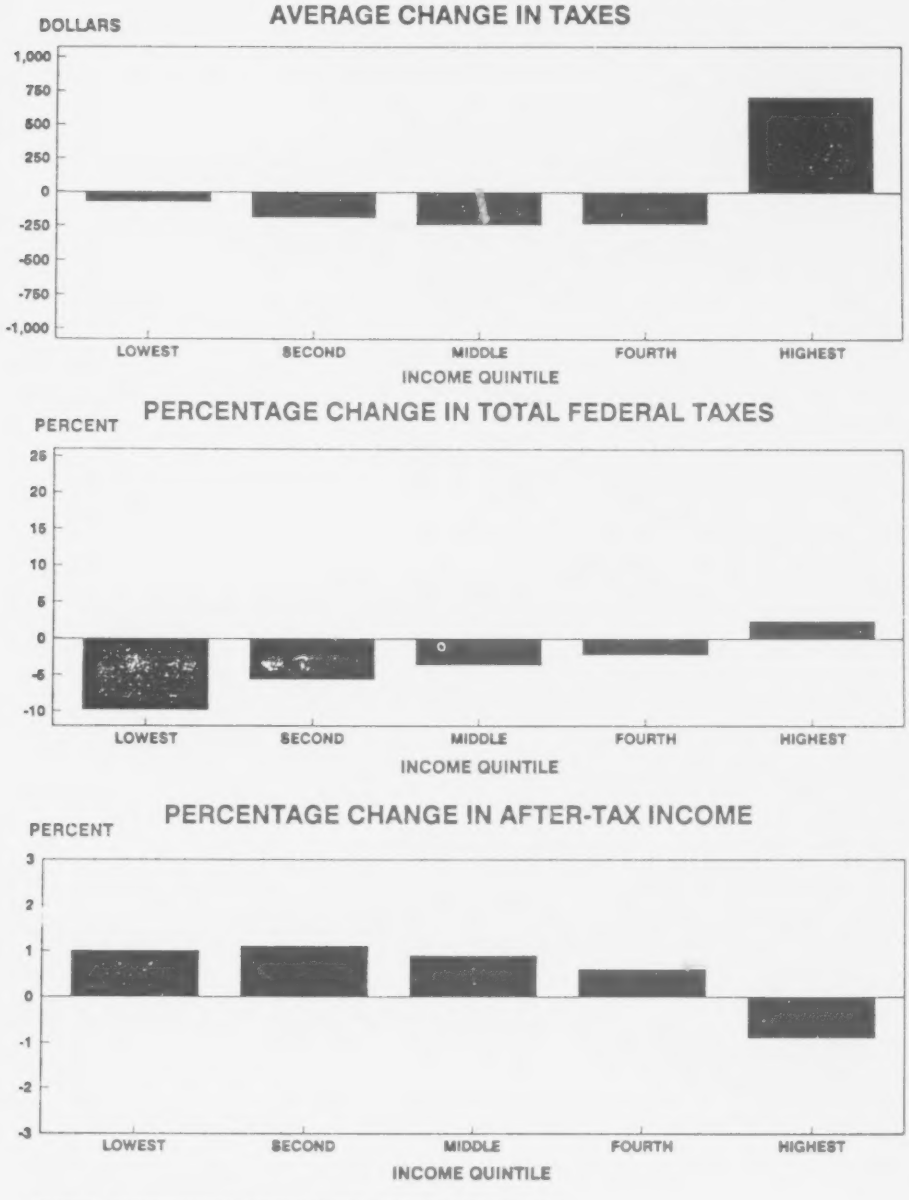
individual income taxes, the U.S. tax system would be more progressive (see Figure 2). About four-fifths of taxpayers would receive net cuts in taxes paid. The relative change in after-tax incomes would range from a 1 percent increase among families in the bottom quintile to a 0.9 percent decrease among families in the top quintile.

Replacing payroll taxes with income taxes would also change the distribution of taxes paid among different types of taxpaying households. The high-income elderly, most of whom do not pay Social Security taxes, would be more likely to pay higher net taxes than younger taxpayers. For example, elderly families in the one-fifth of the population with the highest incomes would face an average net decrease in after-tax income of 1.5 percent compared with a net decrease of 0.9 percent for all families in the top quintile.

Effects of Imposing a Federal Value-Added Tax

If the revenue lost from lowering payroll tax rates were made up by imposing a value-added tax, it would make the

# FIGURE 2. S. 2016 WITH OFFSETTING INCOME TAX SURCHARGE




SOURCE: CONGRESSIONAL BUDGET OFFICE TAX SIMULATION MODELS.

tax system less progressive, as shown in Figure 3.[1] The one-fifth of families with the lowest annual incomes would face the largest net increase in taxes. Many of these households spend more than their annual income by borrowing or by selling assets, as for example would be likely among the elderly. Households in such circumstances would pay relatively little in payroll taxes, and thus would receive little or no tax relief from lowering such taxes, but they would pay value-added taxes on their purchased consumption. Replacing payroll taxes with a VAT would be regressive, with effects ranging from a 2.0 percent decrease in after-tax incomes among the one-fifth of taxpayers with the lowest incomes to a 0.1 percent increase among taxpayers in the highest income quintile.

While replacing payroll taxes with a VAT would make the present tax system less progressive, let me note that these measures overstate the increase in regressivity because a portion of families with low incomes in a particular year are not needy by other standards. Some households, for example, are able to sell assets to pay

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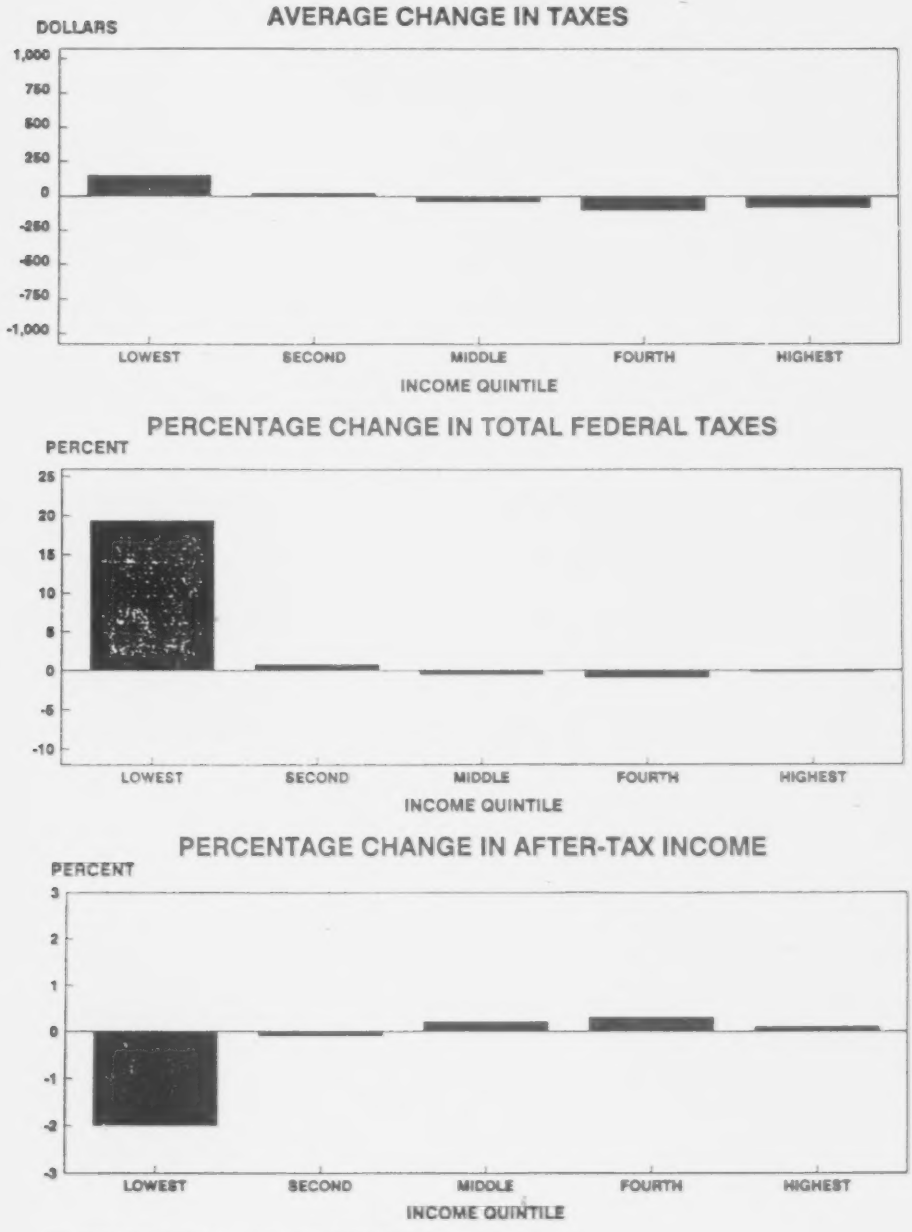
1. The simulations are for a VAT that excludes food purchased for home consumption, housing expenditures (including utilities), medical care, educational expenditures, and contributions to religious and charitable organizations. This VAT is similar to that proposed by Senator Hollings as a replacement for lower payroll taxes.

# FIGURE 3. S. 2016 WITH OFFSETTING VALUE-ADDED TAX




SOURCE: CONGRESSIONAL BUDGET OFFICE TAX SIMULATION MODELS.

for spending that exceeds income. Value-added taxes would take up a larger share of the income of such households than it would of households that finance spending entirely from their annual income. In this case, value-added taxes would appear regressive, even though some families able to pay for spending out of existing wealth may not be needy.

Other Alternatives

Reduced payroll taxes could be offset in many more ways than the two examples discussed above. Some people have suggested that higher gasoline taxes should be considered. A detailed discussion of this alternative is not included in this statement largely because it could have far-reaching effects on the economy, which would require considerable analysis. In order to raise $50 billion in net revenue, it would be necessary to raise the gasoline tax by about 50 cents a gallon--an increase that is beyond the realm of U.S. historical experience. Preliminary simulations of the distributional effects of replacing $50 billion in payroll taxes with higher gasoline taxes, however, suggest that this alternative would be even more regressive than a VAT.

IMPLICATIONS OF S. 2016 FOR SOCIAL SECURITY FINANCING

The previous discussion of the overall economic, budgetary, and distributional implications of S. 2016 does not address the more narrow but equally important issue of how the nation should finance Social Security benefits. S. 2016 has rekindled an old debate on Social Security financing. Should payroll tax rates be set so as to produce annual revenues approximately equal to annual outlays (in other words, pay-as-you-go financing)? Or should a reserve be built up (in other words, partial reserve financing), thereby establishing substantial interest earnings as an important source of financing?

Until 1972, tax rates were scheduled so that significant trust fund buildups would develop in the long run without subsequent legislative action. These substantial reserves never materialized, primarily because benefits were increased sufficiently to absorb the reserves before they could build up. As a result, the program was run on a de facto, pay-as-you-go basis during the 1951-1972 period. The Social Security Amendments of 1972, which indexed benefits to inflation, effectively legislated the pay-as-you-go structure. Five years later, the 1977 amendments reversed course and restored a significant trust fund buildup over the 1980-



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2010 period by moving a scheduled payroll tax increase from 2011 to 1990. For the first time, however, long-range financing was not sufficient to meet anticipated program costs for the next 75 years, and the trust fund buildup was to be dissipated by 2030. This pattern of trust fund buildup and subsequent depletion (now projected to occur in 2046) was magnified by the Social Security Amendments of 1983.

## The Case for Partial Funding

Two principal cases are made for building up a large, payroll-tax financed accumulation in advance of the baby boom's retirement. One case is based on providing greater equity between the baby-boom generation and those that follow them. The other is an explicitly political argument relating to the difficulty of enforcing a surplus in the total federal budget.

The Issue of Equity. If each succeeding generation of Americans is of approximately equal size, pay-as-you-go financing raises no particular intergenerational equity issues. The payroll tax rate for each generation of workers can be held roughly constant and still satisfy

the benefits promised to each generation of retirees. Indeed, later generations of retirees can receive higher real retirement benefits than their predecessors, even if the number of retirees grows somewhat over time, as long as real growth in productivity holds up.

But if, as is the case for the baby-boom generation, there is a discrete jump in the size of one generational group, pay-as-you go financing raises an issue of equity. The baby-boom cohort is able to pay a low payroll tax while working, because there are so many of them paying for a small preceding generation. When the large cohort retires, however, their successors (the groups born since the 1960s) will have to bear a higher payroll tax rate. Given these demographics, advocates of advance accumulation would maintain the current payroll rate, which is above the amount needed for pay-as-you-go financing for the next 20 years. This increase, they contend, would guarantee that the baby-boom generation bears its fair share of the burden and does not stick the succeeding generations with a big, undeserved bill. (Beyond the 20 year mark, payroll rates would again have to be raised to reach a long-term sustainable level, adequate to pay for the projected higher ratio of retirees to workers.)

The Issue of Budget Surpluses. If the only way to raise national savings over the next 20 years is for the government to run large surpluses in its overall budget, doing this outside the Social Security accounts may be politically impossible. To achieve these surpluses with the Social Security accounts held to a balance (as is implied by pay-as-you-go financing) means that the rest of the budget must run a surplus. But today, the rest of the budget is miles from even being balanced, let alone running a surplus. Moreover, the rationale for running surpluses in these non-Social Security accounts has never been sold to the electorate.

In response, the proponents of Social Security accumulation say that the only way to achieve an overall surplus is to aim for a balanced non-Social Security budget (a concept the public has consistently endorsed) accompanied by a Social Security surplus (the public understands the concept of saving for retirement, and the Social Security surplus is already embodied in current law). The Administration's proposed Social Security Integrity and Debt Reduction Fund, I would note parenthetically, seems similarly motivated, as do many of the plans calling for an off-budget treatment of Social Security.

The Case for Pay-As-You-Go Financing

In a practical sense, pay-as-you-go financing (under which rubric I would also include plans for accumulating modest reserves to provide protection against the adverse consequences of recessions) has been the actual system for paying for Social Security nearly since its inception. It bears repeating that this system has worked, and it has met the highest political test: Social Security has built political support unequaled by other programs. Pay-as-you go financing helped build this support.

The Issue of Equity. Looking only at the payroll tax rate over time is too narrow a basis for viewing equity among generations. If the nation chooses to solve its admitted savings problem over the next 20 years, baby boomers will pay the price even with pay-as-you-go financing. For example, if the government imposes higher income or gasoline taxes or cuts public services any time soon, the baby boomers are precisely the ones who will bear the brunt of these. If the baby boomers decide to save more privately as they mature (not an impossibility), then they will be the ones who will have to lower their current consumption. In contrast, succeeding generations are likely to enjoy higher real

wages as a result of labor shortages during the baby-boom retirement years, while baby boomers may have had poorer chances of real wage growth and career advancement during their working years. Moreover, baby boomers may not benefit as much as previous generations when they liquidate their assets, such as homes or thrift plan accumulations, when they retire.

Thus, broader comparisons of the relative economic positions of the baby-boom and subsequent generations suggest little need, if any, to redress inequities. That is to say, there is no reason based on equity considerations to require the baby boomers to bear unnecessarily high payroll rates in the next 20 years.

The Issue of Flexibility. Pay-as-you-go financing has an additional virtue over a rigid plan for running surpluses in Social Security, stemming from the need to keep legislative options open. In practical terms, holding to a course of Social Security buildup for the next 20 years effectively closes the books on changing that program. While in many respects precluding changes in Social Security is a desirable goal, we should always acknowledge that societal changes we cannot now foresee may make certain Social Security changes desireable as well. Consider, for example, marital arrangements,

participation in the work force, immigration, private pension accumulations, life expectancies, health status of the aged, and the changing physical demands of work: all of these have a bearing on how we structure Social Security.

Pay-as-you-go financing keeps the books open on Social Security--not for capricious, short-run fiddling, which everyone should oppose, but for periodic reexamination. By the same token, if we learn that we have got it wrong in making 75-year projections, pay-as-you-go financing will readily permit future adjustments in Social Security or elsewhere, whereas the accumulation strategy, combined with a commitment to maintain total government surpluses, may prove to be too tight a straitjacket.

## Resolving the Issue of Social Security Financing

Finally, let me turn to how to resolve the issue of the proper financing plan for Social Security. Mr. Chairman, as you know, CBO does not make policy recommendations, and I will not deviate from that practice here. But a few observations are in order.

First, the issue of Social Security financing should not be regarded as having been settled by the 1983 Social Security Amendments. The issues I have raised today were not debated in full at that time, and they deserve to be debated before the issue can be considered resolved. Second, it is clear that no substantial policy change in Social Security can be meaningfully decided in isolation. I have already pointed out the links of Social Security to overall national saving and budget policies. I would also add now its obvious link with health care programs for the aged. It is unthinkable to change the payroll tax based on considerations of retirement benefits alone when we know that the Medicare trust funds will be in trouble, probably even before the baby boomers retire. Finally, since the trust fund buildup in the next couple of years is warranted just to offer protection against a recession, there is little need to resolve the Social Security financing issue right away.

## CONCLUSION

Social Security is woven deeply into the fabric of American society. The program affects roughly 133 million workers and more than 39 million beneficiaries, with its payroll taxes accounting for more than one-

quarter of total federal revenues and its benefits constituting one-fifth of total federal expenditures. Nearly two out of every five workers find their own FICA payments exceeding their income tax liabilities, and about three-quarters face combined employee/employer payroll taxes that are greater than their income taxes. More than one-half of aged Social Security recipients depend on these benefits for the major share of their total income. Moreover, millions of other family members receive insurance protection against income lost with the retirement, disability, or death of a worker. These statistics highlight that any program changes, whether they alter benefit payments or the way the program is financed, deserve much careful study and debate.

Large federal deficits combined with relatively low U.S. savings rates jeopardize the future growth in the standard of living for Americans. Without significant economic growth, future taxpayers may be both less willing and less able to support existing federal commitments, including those for Social Security and Medicare. Therefore, S. 2016 raises the issues of not only how we structure our taxes to finance Social Security, but also what our overall commitments should be to savings, investment, and economic growth.

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

Robert D. Reischauer
Director

April 3, 1990

Honorable William J. Hughes
Chairman
Subcommittee on Retirement Income
and Employment
Select Committee on Aging
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

I am pleased to have this opportunity to respond to your questions following up on my testimony before your committee on February 28, 1990. In the attachment to this letter, I have attempted to answer your questions and those of Representative Lloyd.

If you desire further elaboration, please call me or have your staff contact Paul Cullinan (226-2820).

Sincerely,

Robert D. Reischauer

Attachment

cc: Honorable Edward R. Roybal
Chairman
Select Committee on Aging

Honorable Matthew J. Rinaldo
Ranking Minority Member

QUESTIONS CONCERNING SOCIAL SECURITY ISSUES
RAISED BY THE HONORABLE WILLIAM J. HUGHES

Question 1. Will cutting the payroll tax at this point alter the fact that the government will need to raise payroll taxes in the future to help defray the cost of the retirement of the "baby-boomers"?

Answer. The fiscal pressures relating to the baby-boom's retirement will be felt beginning around 2010. Under current law, the Social Security benefits for this large group of retirees will be financed partly through the payroll taxes levied on workers at that time, partly through the taxation of benefits, and the remainder through interest income the Social Security trust funds would receive. The interest income would flow from the large accumulation of trust fund reserves that occurs as a result of collecting more in payroll taxes than those required to cover program costs over the next 20 years. Eventually the accumulated balances would be depleted, and additional funding would be necessary. Continuation of past and current practices would imply a required increase in the payroll tax rate beginning after 2040.

Reducing the current payroll tax rate and scheduling tax rate increases in the next century, as in a pay-as-you-go financing regime, is an alternative and is consistent with the funding practices used in much of the post-WW II period.

In either case, however, federal taxes would have to be raised or other spending would have to be reduced when the federal government would be required to meet its Social Security obligations. The current funding practice would imply that beginning in about 2020 payroll tax receipts would fall short of program costs. Interest income and proceeds from redemptions of Treasury securities, funded through other federal revenues, would make up the shortfall until the trust funds would be depleted in 2046. The pay-as-you-go alternative generally would require additional payroll taxes, although theoretically there is no impediment to supplying the additional funding through transfers of general revenues.

Question 2. Does the current use of the Social Security trust funds add to national savings?

Answer. It is impossible to supply a conclusive answer to this question, as we cannot know how the Congress and the President would have formulated budget policy in the absence of the Social Security surplus. My personal inclination is to believe that at least some of the surplus added to national savings. My position is based on the designation of the Gramm-Rudman-Hollings deficit targets. These targets were originally established in 1985 and modified in 1987. Even by 1985, the prospect of growing surpluses in Social Security was well established in SSA, OMB, and CBO

documents. Had these surpluses not been anticipated, I believe that the GRH targets would have been less ambitious. While compliance with these targets and the necessary budget choices these targets imply has been less than desired, I do think that GRH has had the effect of reducing the deficit from what it otherwise would have been. These reduced deficits translate into increased national savings. I think that less ambitious targets would have resulted in less deficit reduction. It therefore follows that at least some of the Social Security surplus does represent an increase in national savings.

Question 3. Is it possible to "save" the trust funds exclusively for the retirement of the "baby-boom" generation? If not, why are we building a very large reserve of government-issued securities?

Answer. Trust funds within the federal budget are accounting conventions that record available spending authority for certain federal activities including the payment of Social Security benefits. The reserves accumulating in the Social Security trust funds represent claims on the production of the economy in the future. In the narrow sense, this accumulation might be thought of as savings for the baby-boom's retirement. More broadly, however, if the trust fund surpluses do not reduce the overall federal budget deficit from what it would be in the absence of the surpluses, they would not represent net savings. Just as a household's transfer of funds from its checking account to its savings account does not increase the household's total savings, federal accounting practices do not alter the fact that it is total federal borrowing from the public that measures the federal government's impact on national savings. Thus, the focus on national savings involves a concentration on the overall federal budget, not on its components.

Increased national savings is expected to increase investment, thereby enhancing the prospects for productivity growth. It is the resulting increased productivity and national wealth that represent the returns from raising national savings. If Social Security surpluses enable the U.S. to run smaller total deficits or even budget surpluses, then Social Security can help the nation's economy grow. From an economic perspective, it does not matter--at least within broad ranges--whether the savings result from the Social Security accounts or the general fund accounts. It may be easier, however, to convince the American people of the prudence of saving for retirement purposes than for the federal government to run surpluses in the non-Social Security portion of the budget.

Question 4. What is the Congressional Budget Office's opinion on gradually returning the Social Security program back to a pay-as-you-go system?

Answer. The CBO has a practice of not making recommendations on policy issues. From a practical standpoint, either partial advanced funding or pay-as-you-go funding for Social Security represents a viable option.

QUESTIONS CONCERNING SOCIAL SECURITY ISSUES
RAISED BY THE HONORABLE MARILYN LLOYD

Question 1. Let us suppose that we all agree that we need to strengthen our economy by reducing our National debt. What role do you believe the Social Security trust fund should have in working toward such a goal?

Answer. Deciding what role Social Security should play in increasing national savings is a political choice for the Congress. From an economic perspective, it is the entire federal budget that matters, not its constituent parts.

Question 2. From your testimony, it sounds like the Federal Government will by necessity raise taxes in the future to pay for the baby-boom's retirement, but that we can minimize such increases by reducing our deficit and thereby increasing our national savings and productivity. Why not use non-Social Security taxes to attack the current budget deficit and the National debt? Should we increase the most progressive taxes and put the burden on those who can handle it most easily?

Answer. What I tried to convey in my testimony is that Social Security costs will rise in the future and that these added costs will have to be met with higher taxes, reduced spending, or both. Deficit spending is also a possibility, but one which cannot be offered as a long-range solution. Economic growth has only a small effect on future Social Security costs expressed either as a percentage of the GNP or of taxable payroll. What economic growth does is increase national income and wealth which could be expected to increase both the ability and the willingness of taxpayers to allocate a larger share of their budgets to taxes.

The fiscal policy objective of moving the federal budget toward balance can be met through a variety of spending and revenue options. Clearly, the Congress would want to consider how any changes would affect the distribution of tax burdens. On the other hand, the potential effects of spending and revenue changes on investment and on incentives to save would also be factors in these budget decisions. Ultimately, because these choices involve value judgments, these questions can only be answered through the political process rather than through economic analysis.

Question 3. Many experts estimate that the Medicare Hospital Insurance (HI) trust fund will run into great difficulties in the near future. Should the Social Security trust fund surplus be used to fund any shortfalls in the HI trust fund? Would that be possible under our current approach to spending Social Security surpluses?

Answer. I agree that the long-range prospects for HI are far more gloomy than for Social Security and that potentially some portion of the payroll taxes currently allocated to the Social Security program could be reassigned to HI. Although that approach would prop up the HI program for a while, the expected growth in health care costs represents a very serious and difficult problem for the U.S. If the reallocation of tax rates were to forestall serious discussion of how to control Medicare costs and health care expenditures in general, I would certainly have reservations about that course of action.

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

Robert D. Reischauer
Director

April 10, 1990

Honorable Edward R. Roybal
Chairman
Select Committee on Aging
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your letter of March 9. I'm pleased to answer the questions you've asked to complete the hearing record on my February 28 testimony on Social Security financing.

**Question 1:** In your testimony, you note that the "major impetus behind the current effort to reduce the payroll tax is the recent trends evident in the distribution of income and the progressivity of the tax system." You then go on to state that the "increased reliance on social insurance payroll taxes is the major explanation for the reduced progressivity of the tax system." Could you further explain how the progressivity of the tax system has been reduced, and what you would specifically recommend to change this situation? What would you recommend to make the tax system more progressive and at the same time reduce the federal budget deficit?

**Answer:** CBO analysis indicates that federal taxes in 1990 will be less progressive than they were in either 1977 or 1980, but more progressive than in 1985. The distribution of taxes is said to be progressive if the ratio of taxes paid to income rises as income rises, regressive if the ratio falls as incomes rise, and proportional if the ratio is the same at all income levels. In 1990, the effective tax rate (the percentage of family income paid in taxes) for the one-fifth (quintile) of people in families with the highest incomes will be 25.8 percent, slightly less than in 1977 or 1980. The effective tax rate for people in the lowest three quintiles will be higher than they were in either 1977 or 1980.

The labeling of taxes as progressive, proportional, or regressive is presented here as a description of the relationship between taxes paid and income, using standard terminology. I employ these terms only as aids in describing complex developments in a relatively simple way. I don't intend for the terms to imply a judgment about the proper amount of progressivity in the tax system. This is a decision for Congress alone to make.

As you point out, I mentioned in my testimony that increased reliance on social insurance payroll taxes has played a major role in reducing the progressivity of the federal tax system. The system's longstanding dependence on personal taxes--income and social insurance payroll taxes--has increased in recent years. In 1977, 74 percent of taxes came from these sources. In 1989, the share had risen to 81 percent, mostly because of increased dependence on payroll taxes. Although the share of individual income taxes was almost the same in 1989 as in 1977, (45 percent in 1989 in contrast to slightly over 44 percent in 1977), the share of total federal taxes coming from payroll taxes increased significantly over the same period (from 30 percent in 1977 to 36 percent by 1989). Other major tax sources, the corporate income tax and excise taxes, have grown much more slowly and have decreased in importance as revenue sources.

Social Security payroll taxes are levied only on earnings and only below a maximum earnings amount, while the individual income tax is levied on income from all sources. Therefore, payroll taxes are much less progressive than the income tax across most of the income distribution and, in fact, regressive in the upper part of the distribution. Thus, the increased dependence on these taxes as a revenue source has tended to reduce the overall progressivity of the tax system.

**Question 2**: What would you estimate to be the specific short-term and long-term effects on the economy of a significant reduction of the Social Security payroll tax at this time?

**Answer**: Because the economy is operating close to its full capacity now, a significant reduction in payroll tax rates without offsetting deficit reductions elsewhere could harm the economy's performance over the next several years. A significant tax cut could increase total demand for goods beyond the economy's capacity to produce them, leading potentially to increases in both inflation and the trade deficit. The Federal Reserve would be likely to try to head off extra inflation by raising interest rates, which are already quite high by historical standards in inflation-adjusted terms. These higher rates could further reduce investment and complicate many problem areas, such as the cashflow problems of developing countries and domestic corporations

that are already heavily indebted, and could make resolving problems of the thrift industry more difficult.

In the longer term, significant increases in the federal deficit could exacerbate several economic weaknesses, such as low net investment, slow growth in productivity, and faltering competitiveness in international markets. A further increase in the federal deficit from a cut in taxes would divert more of our limited saving away from investment (including research and development) that could increase our productivity, competitiveness, and living standards.

Some analysts have argued that reduced payroll tax rates for employers could help improve the competitiveness of American goods by reducing this component of labor costs, but this outcome seems unlikely. Most studies of the payroll tax conclude that the employers' share ultimately has little effect on employers' cost because it is absorbed by workers in the form of lower wages than they might otherwise get. This implies that reduced employers' rates would be met with offsetting increases in wage rates or fringe benefits. As a result, there might be little improvement in employers' costs, and therefore in the competitiveness of the goods that they produce.

**Question 3:** If the Social Security payroll tax is reduced now would it have to be substantially raised in the future when there will be fewer workers supporting more retirees?

**Answer:** As compared to current law, pay-as-you-go financing of Social Security would result in lower payroll tax rates between now and 2014, higher payroll tax rates between 2014 and 2046, and the same payroll tax rates after 2046. As a share of payroll or of gross national product, however, the total cost of financing Social Security would be virtually the same under pay-as-you-go as under current law.

When the baby-boom generation begins retiring, the federal government will have to transfer more resources to the retirees to whom it has promised payments. To do this, the government will have to increase its claim on the resources that are produced at the time, either by reducing other spending or by raising taxes. According to the 1989 Social Security trustees' report, about 75 percent of benefits in the year 2030 will be supported through payroll tax revenues, 5 percent through income from the taxation of benefits, and 20 percent through interest payments on trust fund reserves. Obviously, nonpayroll tax revenues would have to be used to pay the interest.

If you wish further details, please feel free to contact me or your staff may wish to contact Maureen Griffin of the Tax Analysis Division at 226-2859.

Sincerely,

Robert D. Reischauer
Director

cc: Honorable Matthew J. Rinaldo
Ranking Minority Member

Chairman ROYBAL. Thank you. Mr. Enoff.

## STATEMENT OF LOUIS D. ENOFF

Mr. ENOFF. Thank you, Mr. Chairman. I, too, commend you for holding these hearings. I would like to, with your permission, enter my statement for the record and just make a few comments at this time.

Chairman ROYBAL. Without objection, that will be the order.

Mr. ENOFF. Mr. Chairman, members of the committee, I am pleased to be here today to discuss Social Security financing and the continued long-term financial condition of the Social Security program. Public discussions about these issues is healthy. The public needs to know the current condition of the Social Security program and the implications for the program that are inherent in current legislative proposals. The scheduled buildup of Social Security trust fund reserves has a specific purpose, which is to help finance Social Security benefit payments to today's workers when they reach retirement. Over the near term, it is also important to restoring adequate contingency reserve levels in the trust funds.

As the Advisory Council on Social Security pointed out in its recent interim findings, it is important to protect the trust funds against financing crises like those that occurred under the adverse economic conditions of the late 1970s and the early 1980s. The Council recommended that, regardless of whether Social Security ultimately may be financed on a pay-as-you-go or a partially-funded basis, the scheduled buildup should continue until the trust funds reach adequate contingency reserve levels, about 18 months' worth of benefits rather than the 9 months of benefits on hand today.

In our pursuit of the best policies to achieve these objectives, however, we must be careful to conduct our discussions in a way that promotes the best interests of the people the Social Security program serves. An unfortunate by-product of some of the current discussions is the spread of a good deal of misleading information about Social Security. The most troubling are the statements characterizing trust fund investments as worthless IOUs and distortions about the regressivity of the Social Security tax.

As you know, the law permits the trust funds to be invested only in obligations issued or guaranteed by the United States Government. The reason for doing so is simple enough—safety. Safety has to be the foremost consideration in investing the assets of the Nation's primary economic security program.

These investments are safe. They are backed by the full faith and credit of the United States, the same guarantee that stands behind the savings bonds and other Treasury bonds, bills, and notes that millions of Americans hold. Trust fund investments last year earned nearly $13 billion in interest. I want to point out here that it was at an interest rate of 9.6 percent. I think in my written testimony there is an error; it says 9.7 percent on page 2. It should be 9.6 percent, but it is $13 billion in interest.

Discussions about the regressivity of the Social Security payroll tax also offer a distorted view by ignoring the total program and by ignoring the progressivity that is built into the benefit structure. As you know, the program provides low earners with considerably

higher benefits in relation to pre-retirement earnings than it does for high earners. For people retired today, Social Security benefits replace about 57 percent of the low-income worker's earnings, 42 percent for the middle-income workers, and about 24 percent for the high earners. Overlooked, too, are the benefits that were mentioned earlier that the program provides to family members of retired, disabled, or deceased workers.

I raise these issues because I am convinced that the way we pursue our discussions about Social Security financing and related issues is every bit as important as the issues themselves. It would be regrettable if, in our efforts to promote responsible public debate about Social Security, the debate became framed in ways that unintentionally undermine confidence in the system.

As to the broader issues of Social Security financing, it is vitally important to consider carefully the consequences of abandoning the buildup in trust fund reserves. To reverse course now and abandon the buildup would do a number of things. First, it would expose workers and retirees once again to the uncertainties and anxieties that prevailed less than a decade ago. Also, it would erase the strides we have made in restoring public confidence in Social Security. Moreover, we need to focus our efforts on reducing the non-Social Security budget deficits. To do otherwise would do an injustice to all who must rely on our efforts today to lay the groundwork for a healthy economy in the future.

The Administration has advanced an approach to deficit reduction that fully preserves the integrity of the Social Security trust funds. This proposal, entitled "The Social Security Integrity and Debt Reduction Act of 1990," is reflected in the President's budget for 1991. Under the Administration's proposal, Social Security trust fund reserves will continue to increase. The proposal does not modify the Social Security reserves in any way and prevents Social Security receipts from being spent for any other purpose. Also, the proposal provides that non-Social Security budget deficits will gradually be reduced to zero. The non-Social Security budget will be balanced.

Third, by balancing the non-Social Security budget, the proposal will reduce publicly-held national debt, add to national savings, contribute to capital formation and raise economic growth. The resulting additional output will be available to raise the living standards in the U.S. and to meet Social Security commitments to the babyboom generation that we have been talking about.

Let me emphasize, however, that the director of the Office of Management and Budget, Mr. Darman, has made it clear that the Administration is open to discuss other approaches to deficit reduction, provided that they maintain the integrity of the Social Security trust funds.

In concluding, Mr. Chairman, let me say again that we welcome this discussion. Debate is healthy. I know that we all share the same interest in reducing budget deficits and in preserving the financial integrity of the Social Security program.

I'd be happy to answer any questions which you may have.

[The prepared statement of Mr. Enoff follows:]

DEPARTMENT OF HEALTH & HUMAN SERVICES
Social Security Administration
FOR RELEASE ONLY UPON DELIVERY
Refer to
Baltimore MD 21235

STATEMENT

BY

LOUIS D. ENOFF

DEPUTY COMMISSIONER FOR PROGRAMS

SOCIAL SECURITY ADMINISTRATION

BEFORE THE

SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT

HOUSE SELECT COMMITTEE ON AGING

ON

# SOCIAL SECURITY FINANCING

FEBRUARY 28, 1990

Mr. Chairman and Members of the subcommittee,

I am pleased to be here today to discuss Social Security financing and the continued long-term health of the program.

There has been intense public discussion in recent weeks on the Social Security trust funds, payroll taxes, and related issues. The quality of this discussion will be enhanced by the participation of a well-informed public.

I believe the public needs to be fully aware of the current health of Social Security and its reserves. Social Security's current and future beneficiaries also need to know the full implications for the program that are inherent in current legislative proposals.

The Bush Administration and the Congress share a solemn commitment to protect and preserve Social Security. We want to assure its continued solvency. We are devoted to protecting the long-term integrity of the Social Security program. We want to build even greater public confidence in the system. We each seek to uphold a program that has served millions of Americans well for over five decades.

Effect of 1983 Amendments on Social Security Financing

As we discuss these issues, I think it is important to keep in mind the history of Social Security financing during the last decade. Just 7 years ago, Social Security trust fund reserves were nearly exhausted, and the program stood on the brink of defaulting on its commitments. Retirees feared their benefit payments would be disrupted and many workers, especially younger workers, lost confidence that they would receive Social Security benefits when they reached retirement.

Public opinion polls taken at that time reveal that public confidence in the program had seriously eroded, to the extent that only one-third of the public expressed confidence in the system at the beginning of the 1980's. Since the financing crisis was resolved in 1983, public confidence in the program, which depends in large measure on the public's perceptions about the soundness of Social Security financing, is on the rise.

Today, Social Security is financially sound. Trust fund reserves will increase by about $68 billion this year and are projected to grow consistently over the next four decades. Reserves are expected to surpass $1.5 trillion by the turn of the century and to reach nearly $12 trillion at their peak, around 2030.

Last month, Social Security marked its 50th anniversary of paying benefits, on time and in the right amount, to those who depend on them. The program that issued Ms. Ida Mae Fuller the very first benefit check 50 years ago now serves nearly 40 million Americans each month. We can be proud of the role Social Security continues to play in the lives of so many people, especially America's most vulnerable citizens.

Concerns About Misleading Information

The scheduled buildup of Social Security trust fund reserves has a specific purpose--to help finance Social Security benefit payments to today's workers when they reach retirement.

In our pursuit of the best policies to achieve that objective, however, I would offer one word of caution. We must be careful to conduct our discussions in a way that promotes the best interests of the Social Security program. An unfortunate byproduct of the current discussions is the spread of a good deal of misleading information about Social Security. I am especially concerned about statements describing trust fund investments as worthless IOUs which future generations might not honor and distorted discussions about the regressivity of the Social Security tax. These arguments are wrapped in half-truths and both cause the public unnecessary and unjustified concern.

With respect to trust fund investment policy, as you know, section 201 of the Social Security Act requires that the trust funds be invested only in obligations issued or guaranteed by the United States Government. As such, these investments are backed by the full faith and credit of the United States, the same guarantee that stands behind the savings bonds and the Treasury bonds, bills, and notes held by millions of Americans.

The law restricts trust fund investments to Government obligations, because they are simply the safest form of investment, and safety must be the paramount consideration in investing the assets of the program that is the centerpiece of the Nation's economic security system. Trust fund investments last year earned nearly $13 billion in interest, at an interest rate of 9.7 percent.

Discussions about the regressivity of the Social Security tax present a distorted picture in that they tend to ignore the progressivity built into the program's benefit structure. As you know, the program provides low earners with considerably higher benefits in relation to preretirement earnings than it does for high earners. For workers retiring today, Social Security benefits replace about 57 percent of a low-income worker's earnings, about 42 percent for middle-income workers, and about 24 percent for high earners. Often disregarded, too, are the

benefits the program provides to family members of retired, disabled, or deceased workers.

My point, Mr. Chairman, is that the Social Security tax is an inseparable part of a comprehensive social insurance program, one portion of which should not be viewed in isolation from the rest.

I raise these issues because I am convinced that the way we pursue our discussions about Social Security financing and related issues is every bit as important as the issues themselves. It would be regrettable if, in our pursuit of the best interests of those who are served by the Social Security program, we permitted the debate to be framed in ways that unintentionally undermined our objectives.

Continue Trust Fund Buildup

Getting back to the central issues before you today, Mr. Chairman, I think it is vitally important to consider carefully the consequences of enacting any major changes in Social Security financing at this time. To change course now could:

- Expose workers and retirees once again to the uncertainties and anxieties that prevailed less than a decade ago, and

- Erase the strides we have made in restoring public confidence in Social Security.

Moreover, we need to focus our efforts on reducing the non-Social Security budget deficits. To do otherwise would do an injustice to all who must rely on our efforts today to lay the groundwork for a healthy economy in the future.

I might add that the available evidence suggests that the American people do not support reductions in Social Security taxes that threaten to weaken the financing of the program. A recent Wall Street Journal/NBC News poll found that 53 percent of registered voters oppose rolling back Social Security tax rates. And, in a recent poll of registered voters taken by the Boston Globe, an even larger percentage--72 percent of the respondents--said Social Security taxes should not be cut.

Administration Proposal

The Administration has advanced an approach to deficit reduction that fully preserves the integrity of the Social Security trust funds. This proposal, the "Social Security Integrity and Debt Reduction Act of 1990," is reflected in the

President's budget for FY 1991. Under the Administration's proposal:

- Social Security trust fund reserves will continue to increase along the current path; the proposal does not modify the Social Security reserves in any way, and prevents Social Security receipts from being spent for any other purpose.

- Non-Social Security budget deficits gradually will be reduced to zero--the non-Social Security budget will be balanced.

- Balancing the non-Social Security budget will reduce publicly held national debt, which will, in turn, add to national savings, contribute to capital formation, and raise economic growth. The resulting additional output will be available to raise U.S. living standards and to meet Social Security commitments to the "baby boom" generation.

The Director of the Office of Management and Budget, Mr. Darman, while describing the advantages of this proposal, has also made it clear that the Administration would be open to discussing other proposals to reduce the deficit that also maintain the integrity of the trust funds.

Conclusion

In closing, Mr. Chairman, let me reemphasize that SSA welcomes the opportunity to participate in this discussion. I know that the members of this Committee and the Administration share the same concerns about the need to reduce budget deficits; this issue is clearly the major economic issue facing the Nation.

But the Social Security Administration has a unique responsibility--to ensure that, to the extent the larger debate incorporates discussion of the Social Security program, it contributes to public understanding and does not undermine the confidence that the American people have in the Social Security system. If all of us work to achieve those objectives, the inevitable result will be a stronger Social Security program, equipped to serve the beneficiaries of today and tomorrow as well as it has served those who have benefited from it over the past half-century.

That concludes my statement, Mr. Chairman. I will be happy to answer any questions the Committee may have.

Chairman ROYBAL. Thank you, Mr. Enoff. The committee will now go into a 5-minute rule. That means that each member of the committee will have 5 minutes in which they can make a statement or ask questions.

I will start out the proceedings with 5 minutes. Then, I will yield to my cochairman, Mr. Hughes. Then, each member on both sides of the aisle will have 5 minutes to be used as they wish.

Now, Mr. Reischauer, you stated on page 10 of your written text that, "The notion that meeting Social Security reserves through the Treasury represents a misuse of these funds and reflects a misunderstanding of ear-marked revenues in the Federal budget." When you give an explanation of that, what does that really mean?

Mr. REISCHAUER. The Federal Government has many accounts that it calls "trust funds." Many of these particular funds bring in more receipts than they spend in outlays, so there is a surplus. By law, those surpluses have to be invested in special Treasury securities.

Chairman ROYBAL. In other words, the Social Security trust fund earns interest? Is that what you're saying?

Mr. REISCHAUER. Yes, it does earn interest.

Chairman ROYBAL. All right. What percentage?

Mr. REISCHAUER. Last year, it was 9.6 percent, $13 billion was earned by the trust funds last year.

Chairman ROYBAL. In other words, the trust fund earned at least 9 percent last year.

Mr. REISCHAUER. That is correct.

Chairman ROYBAL. This differs from an answer that was given to me by the director of the OMB. Let me ask a further question. By the year 1993, how much will the Federal Government or the Treasury owe Social Security?

Mr. REISCHAUER. In interest only or totally?

Chairman ROYBAL. Totally.

Mr. REISCHAUER. By the year 1993? Let's do a quick calculation.

Chairman ROYBAL. All right. Now the answer that was given to me at that time was approximately $500 billion.

Mr. REISCHAUER. $481 billion would be CBO's number. That would be the size of the total reserve.

Chairman ROYBAL. $481 billion?

Mr. REISCHAUER. Yes.

Chairman ROYBAL. And how much of that would be interest earned?

Mr. REISCHAUER. That's the stock of Treasury securities that the Social Security system would possess. In one of my tables here, I have the flow of interest payments, which in 1993 would be $34 billion.

Chairman ROYBAL. All right. Well, but that $480-some billion would include interest. Would it not?

Mr. ENOFF. Our figures are just a little different. I guess we have $498 billion as the total, and $39 billion would be the interest for the year 1993. We talked about $13 billion for last year. I'm going to guess, and we can supply this for the record, Mr. Chairman, that interest is going to be about $100 billion of that $498 billion, about 20 percent or so.

Operations of the combined OASI and DI Trust Funds, calendar years 1983-93
(in billions)

| Calendar year | Income | | | | Total outgo | Net increase | Funds at end of year |
|---|---|---|---|---|---|---|---|
| | Total | Net contributions | Interest | All other | | | |
| 1983 | $171.3 | $156.3 | $8.3 | $6.7 | $171.2 | $0.1 | $24.9 |
| 1984 | 186.6 | 180.1 | 3.4 | 3.1 | 180.4 | 6.2 | 31.1 |
| 1985 | 203.5 | 194.1 | 2.7 | 6.6 | 190.6 | 1/ 12.9 | 42.2 |
| 1986 | 216.8 | 209.1 | 3.9 | 3.8 | 201.5 | 2/ 15.3 | 46.9 |
| 1987 | 231.0 | 222.4 | 5.3 | 3.3 | 209.1 | 21.9 | 68.8 |
| 1988 | 263.5 | 251.8 | 8.2 | 3.5 | 222.5 | 41.0 | 109.8 |
| Estimates 3/: | | | | | | | |
| 1989 4/ | 294.2 | 277.1 | 13.1 | 4.1 | 235.7 | 58.5 | 168.3 |
| 1990 | 322.2 | 297.7 | 18.9 | 5.6 | 253.2 | 69.1 | 237.3 |
| 1991 | 347.2 | 316.7 | 25.4 | 5.1 | 270.3 | 76.9 | 314.2 |
| 1992 | 374.4 | 336.6 | 32.2 | 5.6 | 287.9 | 86.5 | 400.7 |
| 1993 | 404.1 | 358.7 | 39.2 | 6.2 | 306.4 | 97.6 | 498.4 |
| Total 1983-93 | 3,014.9 | 2,800.6 | 160.6 | 53.6 | 2,528.9 | 486.0 | --- |

1/ Reflects repayment of $1.8 billion that had been borrowed from the Hospital Insurance Trust Fund under the interfund borrowing provisions enacted in December 1981.
2/ Reflects repayment of $10.6 billion that had been borrowed from the Hospital Insurance Trust Fund under the interfund borrowing provisions.
3/ Estimates are taken from the 1989 Trustees Report, on the basis of alternative II-B assumptions.
4/ Actual total income in calendar year 1989 was $289.4 billion, and, of this amount, interest income was $12.7 billion. Total outgo was $236.2 billion, and the funds at the end of calendar year 1989 were $163.0 billion.

Office of the Actuary
Social Security Administration
March 26, 1990

[The following information was subsequently received from Mr. Enoff:]

Chairman ROYBAL. All right. Now, if you didn't take or borrow that money from Social Security, you would have to go out in the open market and borrow that money. If that is so, you'd be paying an interest rate that is higher than the 9 percent that Social Security now gets.

Mr. REISCHAUER. It would be about the same. The interest rate that the Treasury pays for the special securities that are issued to the Social Security system is an average of the rates that are paid to the public issues that are given out at that time.

Chairman ROYBAL. "About the same" doesn't mean the same. My understanding is that if we go out and borrow that money, it will be more than the interest earned by Social Security. "About the same " can mean that but, whatever it means, it is still a fact that we do borrow from Social Security, and we will owe Social Security in the neighborhood of $500 billion by the year 1993.

In the statement that you made, Mr. Reischauer, it seemed to me that you very much favor continuing the practice of borrowing from Social Security. Is that correct?

Mr. REISCHAUER. Yes.

Chairman ROYBAL. All right.

Mr. Hughes.

Chairman HUGHES. Let me pick up, if I might, on just that issue for a minute. There is a lot of confusion about the trust fund concept because people think in terms of a trust fund as a place where monies are secure, invested in a diversified portfolio, which is there for a rainy day, or for some special purpose.

What we're doing, in essence, is we are borrowing from the supposed trust funds. Basically, they finance government operations today. At some time, those bonds that we created, and it is an obligation that is owing the government, will have to be redeemed eventually. In the year 2030, when under present projections we will have almost $12 trillion in those trust funds, how do you envision they'll be redeemed?

Mr. REISCHAUER. The Social Security trustees will walk down the hall and hand the securities to the Secretary of the Treasury, and the Secretary of the Treasury will provide the resources to the Social Security system. Those resources, as I mentioned, will come out of either higher taxes or reduced spending. That happens irrespective of whether we continue the current situation of running large overall deficits, or if we run large surpluses.

Chairman HUGHES. As they say in Tennessee, there is no free lunch.

Mr. REISCHAUER. There is no free lunch.

Mr. ENOFF. I'd like to follow-up on that point just to say, Mr. Hughes, that you mentioned that in 2030, under current projections, we would have to begin to redeem those bonds. We would begin to spend interest in 2018.

Chairman HUGHES. Well, according to your projections, the interest rate in the year 2030 is going to be close to a trillion dollars. Compounded, you're talking about a trillion dollars in just interest to service that debt. Have I missed something?

Mr. REISCHAUER. The price level will be a good deal higher. A trillion then will not mean the same as a trillion now.

Chairman HUGHES. As Ev Dirksen used to say—

Mr. REISCHAUER. "A trillion here, a trillion there, pretty soon you're talking about real money."

Chairman HUGHES. Let me ask you a question, Mr. Reischauer. How do you feel about immediately taking Social Security off budget entirely and out of the integrated budget?

Mr. REISCHAUER. I think it would be a big mistake.

Chairman HUGHES. Why?

Mr. REISCHAUER. It would be a big mistake for several reasons. Why deficits worry us is because they absorb private saving that could be used for productive purposes that lead to economic growth. The deficit that we should keep an eye on is the total deficit of the government. That deficit consists of all the trust funds plus the nontrust fund accounts together. From a perspective of fiscal policy and economic growth, the overall deficit is the correct target because that is what has an impact on our economy.

If we remove the Social Seurity trust fund from the discipline of Gramm-Rudman-Hollings, and push it over to the side, the first thing that would happen is many other trust funds would want equal status, starting with civil service retirement and military retirement. You would be under extreme pressure to move other trust funds off-budget.

Chairman HUGHES. So you wouldn't do it? Let me ask you quickly a second question. How do you feel about the Porter proposal to make Social Security an independent agency?

Mr. REISCHAUER. He is divorcing himself from that proposal.

Mr. PORTER. It's not my proposal; it's someone's proposal.

Chairman HUGHES. What about the proposal to make an independent agency out of Social Security?

Mr. REISCHAUER. I am agnostic on it. Arguments can be made for creating a separate agency that is—

Chairman HUGHES. Did you say agnostic or—

Mr. REISCHAUER. Agnostic. I can argue both sides of that issue. On the one hand, there is an important reason to keep Social Security policy integrated with other policies of health and human services, namely, Medicare and the policies of HCFA, which would argue for continuing the existing system. On the other hand, increased visibility and possibly more attention would be given to the management of the various problems if Social Security were a separate institution.

Chairman HUGHES. Thank you.

Chairman ROYBAL. Your time has expired. Mr. Porter.

Mr. PORTER. Thank you, Mr. Chairman. If we continue to run the kind of deficits we're running today, and the reserve for Social Security continues to be invested in U.S. Government obligations, and we reach the year 2030 as we're talking about, if I understand you correctly, you said we have two options then. We can either cut other Government spending or raise taxes. Are you at all saying—

Mr. REISCHAUER. That would be true even if we were running a surplus right now. If the budget were balanced except for Social Security, we would still have this problem in the year 2030.

Mr. PORTER. We would also be able to do two other things. We could borrow additionally, perhaps at huge costs because you'd have to borrow a lot of money at that point in time in order to pay the benefits.

Mr. REISCHAUER. Borrowing would not be a sensible option at that point because the adjustment that is being made when the baby boom generation retires is a permanent one. A higher share of GNP will go to retirees for ever after.

Mr. PORTER. Or you could go to hyperinflation and pay off with cheap dollars, which would not help anyone obviously. It seems to me that that tells us very quickly that because Congress is obviously not willing to raise taxes or to cut other government spending, that's why we have the kind of deficit problem we have today. Obviously, the problem is simply exacerbated as time goes on and we continue to do what we're doing and never come to grips with these problems.

You said in your testimony that the best thing that we can do for Social Security is to maximize economic growth, the best thing we can do for economic growth is to take actions that add to national savings, and the best thing we can do to add to national savings is to reduce the Federal deficit and presumably run surpluses. What if, in addition, we would had some kind of mandatory national savings plan so that Americans, that is individuals as well as businesses, save a great deal more than they do today? Wouldn't that also help to maximize economic growth? I certainly agree that the first thing to do is to get the deficit under control.

Mr. REISCHAUER. Certainly it would. We have not been very successful stimulating personal saving in this country in the past. We have tried a number of methods, and none has seemed to have a very strong impact. I realize you have a different approach.

Mr. PORTER. Well, would a plan of the type that I have proposed, which is to take the reserve that is not needed for current benefits, for disability, and for paying a minimum benefit—in other words, maintain the skew in the system—and refunding that into individual Social Security retirement accounts for every American worker each year, and that would be a mandatory savings system, and have that invested in a narrow band of fiduciary-type investments, but broader than U.S. Government obligations obviously, wouldn't that help to maximize economic growth by increasing the national savings rate?

Mr. REISCHAUER. Personal saving would certainly rise. Actually, that's too strong a statement. Personal saving would probably rise; but, at the same time, we would be reducing government revenues. Unless we made up those lost revenues by increased taxes or cuts in other spending programs, government dissaving would rise by exactly the amount by which the personal saving increased.

Next, you would have to ask, "How would individuals respond to this saving, which is under their control?" If they responded, as you have suggested, "I'm more sure of this saving than I was of my Social Security benefits," they might as a result reduce some other saving for retirement. Thus, you might get a slight offset in other types of personal saving.

Mr. PORTER. Except the national personal savings rate is around 3 to 4 percent and—

Mr. REISCHAUER. It's abysmal.

Mr. PORTER. It's abysmally low.

Mr. REISCHAUER. Right.

Mr. PORTER. And that's why we're so dependent upon foreign capital to pay for our deficit and for our economic expansion. That leaves us also with a certain vulnerability to what other countries do.

Mr. REISCHAUER. Correct.

Mr. PORTER. Which would be good to get off of.

Mr. REISCHAUER. Very good.

Mr. PORTER. I guess I've used up my time. Thank you, Mr. Chairman.

Chairman ROYBAL. Thank you.

The Chair recognizes Mrs. Lloyd.

Mrs. LLOYD. Thank you very much, Mr. Chairman. Thank you, gentlemen, for being with us today. I'm not so sure that I'm interested in going to a pay-as-you-go. I haven't reached a conclusion about it. What really troubles me today is I don't think we're really looking at the problem. I think what we are concerned about today is this insidious problem that we are deceiving the American people by not reflecting the true size of our debt. I'm more in favor of pay-as-you-go budget at the present time to really get to the root of our problem.

Even under the Administration's proposal, the budget is eventually balanced using our Social Security receipts in calculating the deficit. This means that the planned increase in payroll tax allowed this to occur. The Administration's proposal allows the surplus from the payroll tax increases to reduce the budget deficit at least through 1993.

Now, my question of you: Why would the Administration prefer to use the payroll tax to just over some other tax? Why is it that we have singled out Social Security?

Mr. ENOFF. Under the proposal, Mrs. Lloyd, I think the non-Social Security part of the budget is required to be balanced so that the trust fund payroll taxes would not be used to mask the deficit at all.

Mrs. LLOYD. The point is why does the Administration insist on using this over another form of taxation?

Mr. REISCHAUER. I think the Administration is proposing just the opposite. It is saying to the Congress, "You have to raise other taxes or cut other spending so the non-Social Security portion of the budget is in balance." Therefore, the excess of revenues over outlays in the Social Security fund will lead to a surplus, as we now measure the deficit.

Mr. ENOFF. It would be used to retire debt or other purposes but not for financing the other non-Social Security budget. It is phased-in.

Mrs. LLOYD. Do you believe the non-Social Security tax is too low to pay for the non-Social Security spending?

Mr. ENOFF. I'm not here to talk about other non-Social Security taxes. The Administration proposal would be to balance the non-Social Security budget. There are a number of ways to do that. Mr. Darman has indicated his willingness to talk about those ways. I think that's a good discussion to pursue with him. What we're saying is that the Social Security trust funds, and the integrity of those funds, should be protected. You can't simply take them off budget without providing for some protection for those funds. If

you do it immediately, you have to figure out what you're going to do with the consequential immediate rise in the deficit.

Mrs. LLOYD. My question is, Why not use non-Social Security taxes for the current budget deficit?

Mr. ENOFF. Well, non-Social Security revenues would be what would be used under the Administration's proposal to finance non-Social Security debt.

Mrs. LLOYD. Thank you very much.

Chairman ROYBAL. Thank you.

Mr. Courter.

## STATEMENT OF REPRESENTATIVE JIM COURTER

Mr. COURTER. Thank you, Mr. Chairman. I was not here earlier for an opening statement, so I'd like to put that on the record if I may.

Chairman ROYBAL. Without objection, it will be the order.

[The prepared statement of Mr. Courter follows:]

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SELECT COMMITTEE ON AGING
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STATEMENT OF CONGRESSMAN JIM COURTER

AT THE HEARING OF THE SELECT COMMITTEE ON AGING

"RETURNING SOCIAL SECURITY TO PAY-AS-YOU-GO FINANCING:

IMPACT ON BENEFITS AND THE FEDERAL BUDGET DEFICIT

FEBRUARY 28, 1990

Mr. Chairman, I want to thank you for calling this hearing today on an issue of fundamental importance to every person in this country, and most importantly our nation's senior citizens. For more than fifty years, the Social Security program has provided a safety net for individuals as they enter their retirement years, guaranteeing that they will have money to pay for groceries, medical care, and the many other necessities which allow seniors to continue to live in dignity and independently even when they no longer bring home a paycheck. Our nation's seniors have reason to be concerned, however, about proposals that would tear a hole in this economic safety net in the name of short-term political gains.

Across the country, millions of Americans are closely following today's debate. They know that the prospects for their financial security in their later years, along with that of their children, depend on the action taken by Congress to protect the Social Security system.

The purpose of today's hearing is to determine whether we should return Social Security to a pay-as-you-go system. I am adamantly opposed to taking such action.

Actuaries warn that while the surplus is large, reserves have not yet reached a safe level to protect against a future recession. The current reserves represent only about 75 percent of one year's benefits. The Social Security Advisory Council, along with most other experts, believe there should be 150 percent of a year's benefits in reserve in case of adverse economic conditions. Under current financing, we will not reach 150 percent until as late as 1994.

Who here can forget the panic that occurred only seven years ago, when Social Security trust funds were drawn down to the point where there was only one month of benefits left. As representatives of the people, it is our responsibility to ensure that this never happens again.

Furthermore, we must remember that the benefits that would be most vulnerable under a pay-as-you-go plan would be the benefits of current workers, the so-called "baby-boomers" that are actually financing the build-up of reserves to ensure their financial security in later years. Their faith in the Social Security system is already low. In fact, a recent national poll

found that Americans under the age of 45 believe nearly 4 to 1 that their benefits will not be available when the reach retirement age. Today's workers fear that the federal government will not be vigilant enough in protecting the trust fund. What kind of signal will we send if we stop providing for their retirement, if we rely on the hope that in twenty years the government will honor its responsibility to provide the funding for this program?

No one likes to pay Social Security taxes. In fact, I have built my career on trying to reduce the tax burden on American men and women. But can we afford to risk the retirement benefits of today's and tomorrow's senior citizens? I say no. We cannot dam the revenue stream that ensures that retirees can live out their golden years with economic peace of mind.

If the recent controversy over the Social Security program has done one useful thing, it has brought to the public's attention the government's underhanded practice of using the Social Security surplus to mask the true size of the federal budget deficit. I strongly oppose this practice.

The Social Security trust fund rightfully belongs to today's workers and those who have worked all their lives, meriting financial security in their later years. The funds should not be

used for any purpose other than to pay back in the form of a monthly retirement check the contributions which rightly belong to seniors. Unfortunately, having the Social Security trust fund on budget is like trusting a child alone in a candy store. Congress's appetite for spending is apparently insatiable. We in Congress have been elected to make hard choices to reduce the budget. Our options should not include raiding the Social Security trust funds, leaving government IOU's in place of retirement savings.

We need to safeguard the integrity of the Trust Funds by taking Social Security off ~~-budget,~~ a proposal which I have long endorsed. By removing the temptation for Congress to spend what is not theirs, this would assure today's senior citizens and tomorrow's retirees that their money will be there for their retirement and will not be used to finance unrelated government programs.

1983 is remembered as the year when the long-term solvency of Social Security was ensured. That year, Members of Congress made a hard decision. We took the heat for agreeing to increases in Social Security contributions that would never have seen the light of day if they were not absolutely necessary to save the Social Security system. Now some Members want to gut that agreement. We cannot allow 1990 to go down as the year

we sacrificed the long-term stability of Social Security for short-term political gains.

The Social Security Trust Funds represent the efforts of millions of workers in our nation. We cannot -- we must not -- violate the sacred trust Americans have placed in us to defend their retirement savings. We must ensure that Social Security continues to receive sufficient contributions to ensure its solvency, and we must take Social Security off-budget without further delay.

Mr. COURTER. Thank you very much.

For more than 50 years, the Social Security program has provided a safety net for individuals, as they enter their retirement years, guaranteeing that they will have money to pay for necessities. Our Nation's seniors have a reason to be concerned, however, about proposals that would tear a hole in this economic safety net in the name of short-term political gain.

Across the country, millions of Americans are closely following today's debate. They know that the prospects for their financial security in their later years, along with that of their children, depends on the action taken by Congress this year.

The purpose of today's hearing is to determine whether we should return Social Security to a pay-as-you-go system. I am absolutely and adamantly opposed to that course of action. Actuaries warn that while the surplus is large, reserves have not yet reached a safe level. Who here can forget the panic that occurred—and it really was panic—only 7 years ago when Social Security trust funds were drawn down to the point where there was approximately 1 month left in the till. It is our responsibility, it seems to me, to make sure that that never happens again.

Furthermore, we must remember that the benefits that would be most vulnerable if a pay-as-you-go plan were adopted would be the benefits of current workers, the so-called baby boomers. Their faith in the Social Security system is low. In fact, a recent poll indicates that those under the age of 45 believe nearly 4 to 1 that their benefits are not going to be available when they reach retirement age. No one likes to pay Social Security taxes, but can we afford to risk the retirement benefits of today's and tomorrow's senior citizens? I don't think so.

The recent controversy over the Social Security program has done one useful thing it seems to me. It has brought to the public's attention the government's underhanded practice of using the Social Security surplus to mask the true size of the Federal deficit. I strongly oppose this practice.

We need to safeguard the integrity of the trust funds by taking Social Security off budget, a proposal which I have endorsed for a long period of time. 1983 is remembered as the year when the long-term solvency of Social Security wasn't sure. That year Members of Congress made a very difficult decision. Now, some members want to gut that agreement. We cannot allow 1990 to go down as the year we sacrificed the long-term stability of Social Security for short-term political gains.

The Social Security trust funds represent the efforts of millions of workers in our Nation. We cannot, and we must not, violate the sacred trust Americans have placed in us to defend their retirement savings. We must ensure that Social Security continues to receive sufficient contributions to ensure it is solvent. We must take Social Security off budget without further delay.

That is my statement.

I have just one quick question in the remaining seconds of my time. Have you estimated the impact on the Social Security trust fund if there was a repeat of the early 1980s recession? That recession was a particularly nasty one and a long one. We have had the boom times, obviously, for about 7 years. What actually would

happen to the trust fund surpluses if that late 1970/early 1980 recession manifested itself sometime in the next couple of years?

Mr. ENOFF. The short answer, Mr. Courter, is we have not estimated an exact replica of what happened in the late 1970s and early 1980s. It is certainly safe to say it would be worse than the alternative III projections that we use in the Trustees' Report. We could do that—we could try and repeat it, if you would liek us to.

Mr. REISCHAUER. Most analysts favor reserves of 100 percent to 150 percent of annual outlays, even under a pay-as-you-go system. That amount would be sufficient to weather 2 back-to-back recessions such as the 1973-1974 recession, without making changes. It would have an impact, but with reserves of 100 percent to 150 percent, we could weather it.

Chairman ROYBAL. All right. Mr. DeFazio.

Mr. DEFAZIO. Thank you, Mr. Chairman.

First of all, we have not misnomered it to say that we have a Social Security trust fund. What we have is a Social Security budget authority savings account. We have BA out there when we can go back and retrieve the money from the obligations of the Federal Government. Let me just go a little bit into the future here in a babyboomer—I'm eccentric. What happens in 2010 when the total amount of the trust fund projected exceeds the total national debt? What do we invest those monies in? How can we do that?

Mr. ENOFF. Obviously, Mr. DeFazio, the thing to do is to resolve the deficit and begin bringing down that debt.

Mr. DEFAZIO. But the point is, if we are successful, if we meet the Gramm-Rudman target and we get to 2010, the amount of money you're projecting to be in the trust fund far, far exceeds the amount of outstanding Federal debt. Where are you going to put that money if you can only invest it in Federal securities and the Federal Government won't need to issue those securities?

Mr. ENOFF. I think we would all like to see that point. There have been studies by the trustees to look at alternative investment sources. They have suggested that there are some other federal investments that could be used. Now, currently the law states that we can buy only interest-bearing obligations of the U.S. Government, obligations guarenteed as to both principal and interest by the United States, and certain other federally sponsored agency obligations. There have been other suggestions. We are certainly far from approaching a problem on that issue at this point in time.

Mr. DEFAZIO. Well, I'm going to take a long-term perspective. The point is, Reischauer talks about productivity and the investment in savings and that. The question is: Where can one enhance productivity the most in the economy? Are we restricting ourselves to only the special Treasury bonds because it is the safest investment? I question that because there is no money there. Or, are we restricting ourselves to give the Federal Government a preferred rate of interest, subsidize current operations, and it's convenient? I mean, I would like to begin to deal with the question today in terms of the diversification of those investments. Maybe we can get some real assets out there that we can cash in in the private sector, and we know we'll be able to sell them, instead of an IOU in 2010.

Mr. ENOFF. I think the primary purpose of safety was certainly at the root of the legislative authority to invest where they are invested.

Mr. DEFAZIO. When was that?

Mr. ENOFF. That was at a different time; that was in the 1930s.

Mr. DEFAZIO. Right.

Mr. REISCHAUER. It is unquestionable that Treasury securities are the safest investment available.

Mr. DEFAZIO. You're not sitting on my side of the aisle?

Mr. REISCHAUER. What lies behind those securities is the taxing power of a sovereign government, which will not be affected by whether General Motors goes out of business or IBM changes hands.

Mr. DEFAZIO. Or if 300 savings and loans go broke.

Mr. REISCHAUER. If 300 savings and loans or 600 savings and loans go broke, we still have that taxing authority—

Mr. DEFAZIO. But we don't put Social Security off budget.

Mr. REISCHAUER.—the taxing authority can tap into the overall resources available in our economy.

Mr. DEFAZIO. Right. What would be wrong with diversifying some of our investments now?

Mr. REISCHAUER. The reason people diversify is to reduce risk.

Mr. DEFAZIO. Right.

Mr. REISCHAUER. I'm suggesting that.

Mr. DEFAZIO. Let me give you an example. My State has a public employee's retirement fund. The average yield far exceeds the average yield—and it has been successful for more than 30 years—far exceeds the average yield that Social Ssecurity receives in these so-called safe IOUs that were bought.

The question is: Are they not being prudent? If they were being ultimately prudent, which our Constitution requires, I guess they ought to put it all in Treasury notes? Somehow, they don't do that, and somehow they make a lot more money. The question is: If we want to maximize the income of Social Security, why not look at diversification now because we are sure as hell going to have to look at it in 2010? In 2010, there aren't going to be enough Treasury bills out there to buy, and then you'll want to go out and buy Ginny Mae's and Fannie Mae's.

Mr. REISCHAUER. By saying that, you're an optimist about the future course of the deficit.

Mr. ENOFF. Your State has also had better experience than others. There have been losses.

Mr. DEFAZIO. We can teach folks.

Mr. REISCHAUER. Everybody can't earn above average rates of return. It can happen in Lake Woebegone, but not in the Nation as a whole.

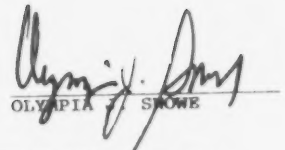
Chairman ROYBAL. Your time, gentleman, has expired.

Mrs. Snowe.

Mrs. SNOWE. Thank you, Mr. Chairman. I ask you now to consent to including a statement in the record, Mr. Chairman.

Chairman ROYBAL. Without objection, it will be the order.

[The prepared statement of Mrs. Snowe follows:]



OLYMPIA J. SNOWE

STATEMENT BEFORE THE HOUSE SELECT COMMITTEE ON AGING AND THE SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT

"RETURNING SOCIAL SECURITY TO PAY-AS-YOU-GO FINANCING: IMPACT ON BENEFITS AND THE FEDERAL BUDGET DEFICIT"
February 28, 1990

Mr. Chairman, I wish to thank you for calling this hearing which reviews the relationship between Social Security and the overall federal budget. This complex issue involves two very important, interrelated concerns -- the need to assure that benefits are available for both current and future retirees and the need to reduce the federal budget deficit.

I am pleased that this hearing affords us the opportunity to learn of the various opinions of individuals who are regarded as experts in the field of Social Security financing. The knowledge that we gain from this hearing is certain to be of substantial benefit as Congress continues to examine this critical issue.

Mr. Chairman, I again wish to thank you for calling this particularly valuable and timely hearing. I look forward to the comments of the witnesses here today.

Mrs. SNOWE. Do you agree with the premise of the Social Security Commission of 1983 in developing a pay-as-you-go system?

Mr. REISCHAUER. Me?

Mrs. SNOWE. Yes.

Mr. REISCHAUER. I don't think our system is pay-as-you-go right now.

Mrs. SNOWE. I'm sorry, taking us off the pay-as-you-go system to prepare for the baby boomers' retirement.

Mr. ENOFF. Let me say that I don't think it was the 1983 Commission that set that course. That started in 1977 in terms of building a partial reserve. In fairness, I don't think the 1983 Commission specifically addressed that, but they certainly agreed to keep on that course by the actions that were taken.

Mrs. SNOWE. Did they actually discuss it? I'm curious because Senator Moynihan was part of that commission, right? They must have known or anticipated the kind of surpluses that would be built up within the Social Security trust fund because they developed a multi-tax system over this last decade.

Mr. ENOFF. I think it certainly was known. I would say this: You're going to have two persons who were intimately involved in that commission up next. You can ask them about the discussions. I think that they did not specifically address, as an issue, pay-as-you go. That has been pointed out. They certainly did endorse the continued build up of trust funds.

Mrs. SNOWE. Yes, and they obviously calculated the kind of surpluses that we have today.

Mr. ENOFF. The economy has been doing better than was projected, but they certainly did project a surplus at that time.

Mrs. SNOWE. Did they project two recessions to occur within this last decade—since 1983 when we passed the legislation?

Mr. REISCHAUER. Remember, they were making a projection just when we were coming out of the recession.

Mrs. SNOWE. That's right.

Mr. REISCHAUER. We have had 7 years of steady growth from then on. What they did was reaffirm the financing decisions that were made in 1977. I don't think they were concerned about the annual year-to-year surpluses. In fact, the reserves are twice as large now as anticipated at that time. That is the sum of all the surpluses we've had since 1984.

Mrs. SNOWE. Okay. Would you feel comfortable with only having a year's reserves?

Mr. REISCHAUER. Yes. I'm not one who loses sleep over this larger issue. Even if I were a baby boomer, I would not be nervous about the future. One has to ask, "What lies behind the security of Social Security?" I would say that there are three things. One is a moral commitment that we, as a Nation, have to our retirees, and we have never really gone back against those commitments.

The second is politics. The aged have been a very powerful lobby in America, and they are going to be a much more powerful lobby with the baby boom generation. It is going to be hard to take the bananas away from the 800-pound gorilla when you haven't been able to take them away from the 200-pound gorilla.

Third, if we continue along this route, there will be large reserves built up, and baby boomers can make a very good argument,

which is, "You can't cut my benefits because those paper securities in the vault indicate that I have paid for the benefits you owe me." So those three things will be buttressing the baby boomers retirement benefits, all of them much stronger than for existing retirees

Mr. ENOFF. Could I answer, too, as one who was involved back in the early 1980s when we had the problem we had with the financing. I'm not comfortable with a 100 percent reserve level. The Advisory Council has recommended that we keep building to get reserves more in line with 150 percent. We're only at 9 months' worth of benefits right now, so I think we agree that we need to go further. Having that reserve level is prudent management.

Mrs. SNOWE. Thank you.

Chairman ROYBAL. The gentlewoman's time has expired.

The Chair now recognizes Mr. Vento.

Mr. VENTO. Thank you, Mr. Chairman. I think we owe a debt of gratitude to Senator Moynihan and others that advanced this issue. I think it stops the digging before the hole even get deeper with regards to this. I well remember the 1977 Social Security Act. It was really benchmark legislation. It set the path for the solvency of Social Security, not the 1983 law.

Mr. Enoff, historically, in the last 25 years, what have been the surpluses in the Social Security system? You mentioned a 9-month surplus now. Maybe you're suggesting the Administration is seeking an 18-month surplus.

Mr. ENOFF. I'm not suggesting that's the Administration's position, but I said that certainly—

Mr. VENTO. Well, I don't want to put words in your mouth.

Mr. ENOFF. That's fine.

Mr. VENTO. What has been the history? The history is not a pay-as-you-go system. The 2- or 3-month surplus that existed in 1982 was not unusual, I don't think, during that 20- or 25-year period. I know if we go back to the history, in 1950 when nobody was getting benefits, and there were 50 workers for every one retiree, it was a wonderful system. Nobody was eligible at that time, so it looked very good.

I think we are getting into the real world now, where 95 percent of the people that retire are on Social Security. What has been the amount of the surplus? Do you understand my question?

Mr. ENOFF. Yes. I think I understand your question. First, though, I think a premise you made, something you said about the 1982 or 1983 amendments not being necessary? Can I understand that a little better?

Mr. VENTO. Well, why don't you respond to the question.

Mr. ENOFF. The 1977 amendments, as you indicated, projected this buildup in the trust funds, and then we had an economic performance that didn't allow for that buildup projected for that period of time.

Mr. VENTO. You didn't answer my question anyway. How about the question I asked?

Mr. ENOFF. The question you asked, is 9 months the largest reserve that we have had in the recent past. Yes, it is.

Mr. VENTO. Nine months is the largest reserve that we've had in the recent past.

Mr. ENOFF. Yes. I can give you a year-by-year rundown.

Mr. VENTO. It might be good for the record.

Mr. ENOFF. We would be glad to supply that.

Mr. VENTO. The point that I'm trying to make is that this is not unusual. In fact, it is extraordinary in terms of what's going on. Now, we know that the effective rate of taxation, is 7.65 percent, with the employer paying a similar amount, none of which is deductible at the State level, and none of which is deductible at the Federal level. So, the effect is that those workers are actually paying a higher rate. They have to pay federal tax on that money they have already paid as a Social Security tax. Is that correct?

Mr. ENOFF. Yes. That's the current tax system. That's correct.

Mr. VENTO. So actually, in order to project that, it actually comes up, if you're in the 28 percent bracket or the 15 percent bracket, at least a portion of that you would actually pay over and above that amount. Is that correct?

Mr. ENOFF. That is correct except that I would point out, just so we're totally accurate, there is the earned income tax credit for workers with children, and the self-employed who pay the full amount themselves do get an offset.

Mr. VENTO. They get an offset of 8 percent of the total that they pay.

Mr. ENOFF. There are 2 deductions, a self-employment income deduction for Social Security tax and coverage purposes, and an income tax deduction for one-half of the self-employment taxes paid.

Mr. VENTO. They used to get about 50 percent. Of course, it's important to fund the system that someone bears those deductions or paybacks as they were in the 1983 law.

Mr. ENOFF. Including the taxation of—

Mr. VENTO. The contributions of the Government.

Mr. ENOFF. That's correct.

Mr. VENTO. The fundamental tax was actually placed in 1977 and then accelerated in 1983 along with some other things that may or may not have been necessary.

Mr. ENOFF. Correct.

Mr. VENTO. But, in my judgment, that is not a significant basis or benchmark for the system today. We have established, then, that the 9-month surplus is the greatest surplus that we've ever had in recent history. My point is, and I appreciate this being brought up, that I think we clearly have to, just from my own statement to my colleagues, deal with this in the overall context of tax policy. We can't deal with it in isolation.

I think the budget director gets very concerned about this just looking at the overall deficit, and well he should, and well we all should. I think that this will have to be considered with every tax policy that comes down the road in the future.

We have a couple of proposals before us dealing with the privatization of Social Security. It is apparent that low-income individuals get greater benefit back from the system. They also, of course, pay, but under a privatization scheme, there would not necessarily be that type of a benefit to lower-income individuals. Would that be correct?

Mr. ENOFF. I haven't seen a formal proposal, so I hesitate to respond to you. I'd be glad to give you an answer once I see a formal proposal.

Mr. VENTO. I haven't read it either, but the impression I have is that people would retain what they would otherwise pay into Social Security. Obviously, those earning above $51,000 would be able to retain more. I think the question that is relevant to you is that there is a disproportionate payout for lower-income individuals in the Social Security system. Is that not correct?

Mr. ENOFF. Yes, currently lower-income people get a higher return in terms of benefit rate. If I understand the principle of the proposals that have been forwarded, the same percentage of earnings for low-income or high-income workers would go into these funds.

Mr. PORTER. Would the gentleman yield? If you're referring to my proposal—

Mr. VENTO. I am.

Mr. PORTER. —it would retain the same skew as the present system.

Mr. VENTO. I appreciate that.

Chairman ROYBAL. The time of the gentleman has expired.

Mr. ENOFF. If I could just clarify for the record, Mr. Chairman, the last—Mr. Ballantyne points out to me that the last time that we reached a 100 percent reserve was in 1970 when it reached 103 percent, and it came down since then. We'll give you the numbers for the record, though, year by year.

Chairman ROYBAL. I would appreciate it for the record.

[The following information was subsequently received from Mr. Enoff:]

Assets at beginning of year
as a percentage of expenditures during year,
for the combined OASI and DI Trust Funds,
calendar years 1966-90

(Amounts in billions)

| Calendar year | Assets at beginning of year 1/ | Expenditures during year | Contingency fund ratio 2/ |
|---|---|---|---|
| 1966 | $19.8 | $20.9 | 95% |
| 1967 | 22.3 | 22.5 | 99 |
| 1968 | 26.3 | 26.0 | 101 |
| 1969 | 28.7 | 27.9 | 103 |
| 1970 | 34.2 | 33.1 | 103 |
| 1971 | 38.1 | 38.5 | 99 |
| 1972 | 40.4 | 43.3 | 93 |
| 1973 | 42.8 | 53.1 | 80 |
| 1974 | 44.4 | 60.6 | 73 |
| 1975 | 45.9 | 69.2 | 66 |
| 1976 | 44.3 | 78.2 | 57 |
| 1977 | 41.1 | 87.3 | 47 |
| 1978 | 35.9 | 96.0 | 37 |
| 1979 | 31.7 | 107.3 | 30 |
| 1980 | 30.3 | 123.5 | 25 |
| 1981 | 26.5 | 144.4 | 18 |
| 1982 | 24.5 | 160.1 | 15 |
| 1983 | 24.8 | 171.2 | 14 |
| 1984 | 38.3 | 180.4 | 21 |
| 1985 | 46.4 | 190.6 | 24 |
| 1986 | 58.5 | 201.5 | 29 |
| 1987 | 65.2 | 209.1 | 31 |
| 1988 | 90.5 | 222.5 | 41 |
| 1989 | 134.4 | 236.2 | 57 |
| 1990 | 188.9 | 3/ 252.8 | 75 |

1/ Beginning with 1984, includes advance tax transfers.
2/ Percentage shown, when multiplied by 12, represents the number of months of expenditures that can be met by the assets at the beginning of the year (e.g., 75% at the beginning of 1990 represents 9 months of expenditures).
3/ Estimated, based on economic assumptions underlying the President's 1991 Budget.

Office of the Actuary
Social Security Administration
March 26, 1990

Chairman ROYBAL. The Chair recognizes Mr. Regula.

Mr. REGULA. Thank you, Mr. Chairman. Question: what percent of the present national debt consists of Social Security investment?

Mr. REISCHAUER. It is a relatively small fraction now because we have somewhere between $160 billion and $200 billion worth of reserves.

Mr. ENOFF. It is about $163 billion right now.

Mr. REGULA. So it's really in the long-term that you get into the—

Mr. REISCHAUER. Well over $3 trillion.

Mr. REGULA. Second, am I correct that Medicare is probably going to cross the line in the near future in the sense that the revenues will be less than the outlays, and that some of the Social Security surpluses will be needed to fund Medicare?

Mr. ENOFF. Certainly there are projections that indicate, with the increasing costs in Medicare, that could happen. We are working to try and prevent that happening. I would say that the current statute would require legislation to move OASDI trust funds into Medicare.

Mr. REISCHAUER. The Medicare system has been projected to go into deficit for about 15 years. Remember, back in the mid-1970s, we thought this would happen in the late 1980s. Then it was pushed off to the early 1990s, then the late 1990s. Now it's into the first decade of the next century, in large measure because of the steps that the Congress has taken virtually every year to rein in the expenditures on Medicare and to reform that system. As you know, the Congress took some significant steps last fall that should push off the projected deficit even further.

Mr. REGULA. It is alleged that this hides the true budget deficit. In reality, in terms of the deficit numbers, it is clear, if you read the budget, as to what portion is Social Security, am I correct, so that it is not really hidden if you want to examine the numbers?

Mr. REISCHAUER. Yes. I am actually at variance with the vast majority of this committee with respect to this issue of masking the deficit or hiding the true deficit. When we established the Gramm-Rudman-Hollings targets in 1985 and then reset them in 1987, we knew full well that Social Security was going to run large and growing surpluses.

The deficit targets were established with that knowledge. Had we been living in a situation where those surpluses weren't going to exist or weren't going to grow as rapidly as projected, my guess is that the Congress would have set very different deficit targets, probably much higher ones.

If the Congress had not, my guess is that the gap between what we said we were going to achieve and what we did achieve would have been much greater. This notion that it was a surprise or that it wasn't taken into account is wrong. As you pointed out, Mr. Regula, since 1986, OMB, CBO, and the budget resolutions that the Congress has passed have all explicitly labeled the surplus in Social Security and the deficit in the non-Social Security portion of the budget, and then the sum of the two. A good deal of attention has been focused on this situation.

Mr. REGULA. Last question: perspectively, would I be correct in saying that the real key to addressing the ability to pay out into

the 2010 and 2020 will be, first growth in the economy, and second holding down the rate of inflation? Because those numbers that we project today, if there is any sizable amount of inflation, would be not really meaningful in purchasing power for the recipients at that time.

Mr. REISCHAUER. But the benefits are indexed, so inflation really doesn't make much difference. As the nominal size of the economy grows, the nominal amount of tax revenue grows, and—

Mr. REGULA. Benefits are indexed but not necessarily the reserves.

Mr. REISCHAUER. That is true. That would be true if, in your example, we suddenly had a 40 percent jump in inflation in the year 2015, or if we had a low rate all along. I am presuming that if we kicked up the inflation rate a percentage point or two and then asked, "How would things be different" the answer would be that the reserves would be a lot bigger.

Mr. REGULA. Thank you, Mr. Chairman.

Chairman ROYBAL. The time of the gentleman has expired.

The Chair recognizes Mrs. Bentley.

Mrs. BENTLEY. Do either one of you consider the Social Security tax regressive?

Mr. ENOFF. Well, I don't because of the progressivity in the benefit structure. As I indicated in my remarks, the low-income wage earner would receive about 57 percent of pre-retirement earnings, the medium-income earner about 42, and the high-income earner about 24 percent, so that a low-income worker would receive back his or her taxes with interest in about 4 years after retirement—so I would say "no."

Mr. REISCHAUER. Examining the tax in isolation, which was really your question, the answer is that it is mildly regressive. It is proportional to earnings. As family income rises, a larger fraction of total income tends not to be in earnings. For individuals with earnings over $51,300, of course, there is no tax.

It is important, as Mr. Enoff points out, to look at the system as a whole because the tax does not exist in isolation as the corporate income tax does or the cigarette tax or the income tax. The Social Security tax is set, in some ways with respect to benefits. One might also include in this calculation the fact that we are beginning to tax a small portion of benefits among the higher-income retirees.

Mr. ENOFF. I think it is a very important point that we look at the whole social insurance system, and that we're talking about benefits. Disability benefits are included, survivor's benefits, benefits for dependents of family members, and so we can't just pull out the tax and look at it in that regard.

Mrs. BENTLEY. From time to time, I have had some of my constituents say, "I would like to be able to put my own money away, and invest it, and take care of my own retirement." Maybe that constituent might do it, but I have often wondered how many people really would do it if they were give a choice about Social Security versus doing your own IRAs or investment permanently.

Mr. REISCHAUER. The whole notion behind a social insurance program like Social Security is the belief that the average person in America would not save as much over his or hers lifetime as would

be optimal from the society's standpoint. Some would; some wouldn't. As you know, we pursue certain redistributional objectives in our Social Security system.

Mrs. BENTLEY. In about 30 years, the trust fund is going to contain $12 trillion in assets. What percentage of the economy, or the GNP, is Social Security expected to represent then?

Mr. ENOFF. We reach the $12 trillion level of reserves in 2030, but the maximum percentage of GNP is 30 percent. That is reached, I think, about 10 years before that.

Mr. REISCHAUER. As a percent of GNP, the federal debt right now is higher than 30 percent. Going back to Mr. DeFazio's question, we started at around 27 percent in the later 1970s, and we are up to 42 percent or 43 percent of GNP at this point.

Mrs. BENTLEY. One of the shortages we have in this country is capital funds for our industries for modernizing, for investment, for developing—let's say HDTV. With all of the pressure that there is of "let's take the Social Security trust fund out of the budget and set it over here," wherever over here is, would it make any sense or is there a possibility of "let's take the trust fund and devote half of it to making the funds available for reindustrializing America," so we can become competitive again?

Mr. REISCHAUER. The real issue is not a Social Security issue; it is a government issue. If you took Social Security surpluses and reserves and put them aside over irrespective of what you did with them, the major issue is what would happen to the rest of the budget? You would be taking a lot of revenues away from the Federal Government. Would you make up those revenues by raising other taxes or by cutting other spending?

If the answer to the question is "yes, we would make up those revenues," about which one has to be a touch skeptical given the record of the past few years, then the answer to your question would be that would help reindustrialization and would help bring down interest rates, so that people in Toledo can get a mortgage. It wouldn't really matter whether the funds were invested privately or remained in Treasury securities. The real issue is the overall need of the Federal Government to borrow from the private sector.

Mr. ENOFF. The point that I need to emphasize, though, is that the funds need to be protected. They are protected now; they are safe now. They need to be in a protected position. We cannot afford to have the basic security program of our country invested in an unprotected manner.

Chairman ROYBAL. Your time has expired.

Mrs. BENTLEY. Mr. Chairman, one thing, I have a statement I'd like included.

Chairman ROYBAL. Without objection, that will be the order.

[The prepared statement of Mrs. Bentley follows:]

STATEMENT OF HELEN DELICH BENTLEY
SELECT COMMITTEE ON AGING
FEBRUARY 28, 1990

Mr. Chairman, —

I appreciate the opportunity today to discuss the relative merits of what has amounted to the years first political "hot potato." As we all know, Congress and the public have been swept into a fierce debate over Senator Moynihan's proposed roll back of the payroll tax. This reduction would place present financing on a "pay as you go" track, thereby eliminating the "save for a rainy day" policy we have been following since 1983 and also end the practice of masking the deficit.

There is no questioning the fact that this proposal appeals to a great many people who believe that the present payroll tax structure is far too regressive. There are also a lot of people out there who have little faith in the long-term survivability of the Social Security system and don't want to pay one penny more in taxes than is necessary. I can understand these frustrations but it is imperative that we keep our eye focused on the ball --- not our distinguished former Social Security Commissioner but the deficit ball --- to ensure that we implement policies that will result in our not needing the surpluses to fund anything but Social Security.

I think that the President hit the nail on the head when he cautioned against fooling around with the present structure during his recent State of the Union address. If I recall correctly, Senator Moynihan even rose to applaud that remark. He certainly realizes that he's playing with matches on this one!

I think that the White House and Congress need to quit playing politics with social security and start spending that energy on our more immediate crises --- namely the budget deficit and health care. Thank you again Mr. Chairman for bring these distinguished guests into the same room, I look forward to hearing their testimony.

Chairman ROYBAL. The Chair now recognizes Mr. Clinger.

Mr. CLINGER. Thank you, Mr. Chairman. I also have a statement I'd like included in the record.

Chairman ROYBAL. Without objection, it will be the order.

[The prepared statement of Mr. Clinger follows:]

STATEMENT OF REPRESENTATIVE WILLIAM F. CLINGER, JR.

FIRST OF ALL, I WOULD LIKE TO THANK THE CHAIRMEN AND RANKING MEMBERS OF THE COMMITTEE AND SUBCOMMITTEE FOR THEIR WILLINGNESS AND INTEREST IN CONDUCTING A HEARING ON THE SOCIAL SECURITY TRUST FUNDS. CLEARLY A PROGRAM WHICH AFFECTS SO MANY AMERICANS DEMANDS CLOSE CONGRESSIONAL ATTENTION.

STARTED OVER 53 YEARS AGO, SOCIAL SECURITY HAS BECOME OUR MOST POPULAR AND SUCCESSFUL SOCIAL PROGRAM FROM WHICH ALMOST EVERY ONE OF US PARTICIPATES EITHER IN THE FORM OF PAYROLL TAXES OR BENEFITS.

~~BACK IN 1983~~, I SUPPORTED THE CREATION OF THE SOCIAL SECURITY TRUST FUND AS I AGREED THAT WE NEEDED TO BUILD UP THE RESERVES TO EASE THE RETIREMENT CRUNCH OF THE BABY BOOMERS.

WHAT I DO NOT SUPPORT IS USING THE TRUST FUNDS FOR PURPOSES FOR WHICH THEY WERE NOT INTENDED, MORE SPECIFICALLY TO MASK THE TRUE SIZE OF THE BUDGET DEFICIT.

THE PROPOSAL ADVANCED BY SEN. MOYNIHAN IS WELL-INTENTIONED AND HAS SERVED A USEFUL PURPOSE BY SPOTLIGHTING THIS DECEITFUL PRACTICE. BUT RETURNING SOCIAL SECURITY TO A PAY-AS-YOU-GO SYSTEM IS NOT THE CORRECT APPROACH TO THE PROBLEM. WHAT MAKES MORE SENSE AT PRESENT IS TO CONTINUE BUILDING UP THE RESERVES IN THE SOCIAL SECURITY TRUST FUNDS WHILE AT THE SAME TIME MOVING IT OFF-BUDGET TO PROTECT THE RESERVES FROM THE SPENDING PROCLIVITIES OF CONGRESS.

WHEN WE ARE ABLE, A MUCH MORE AMBITIOUS PLAN ADVANCED BY REP. JOHN PORTER MAKES A LONG-TERM AND SERIOUS ATTEMPT AT THE SOCIAL SECURITY ISSUE BY USING THE OPPORTUNITY WE NOW HAVE, WHEN THERE ARE ACTUALLY RESERVES IN THE TRUST FUND, TO BEGIN TRANSFORMING SOCIAL SECURITY INTO VESTED, FUNDED, WORKER-OWNED INDIVIDUAL RETIREMENT ACCOUNTS.

UNDER THE PORTER PLAN, THESE INDIVIDUAL SOCIAL SECURITY RETIREMENT ACCOUNTS (ISSRAs) WOULD BE OWNED BY THE WORKER AND WILL BE INVESTED WITHIN CERTAIN SAFE INVESTMENT GUIDELINES. THIS WAY THE SOCIAL SECURITY TRUST FUND IS TAKEN OUT OF THE REACH OF CONGRESS. IT ALSO WILL ASSURE THAT THESE FUNDS ARE ACTUALLY BEING SAVED AND INVESTED TO PAY FOR AN INDIVIDUALS RETIREMENT. IN ADDITION, ISSRAs WOULD BOOST THE NATIONAL SAVINGS RATE AND MAKE THE UNITED STATES LESS DEPENDENT ON FOREIGN CAPITAL.

AS I MENTIONED EARLIER IN MY STATEMENT, THE ANSWER TO THIS PROBLEM DEPENDS ON THE DECISIONS WE IN CONGRESS WILL MAKE IN THE COMING MONTHS. WILL WE USE THE TRUST FUNDS AS INTENDED TO BUILD UP A RESERVE POOL OF MONEY FOR FUTURE RETIREES AND TO INCREASE OUR NATIONAL SAVINGS RATE, OR WILL WE CONTINUE TO USE THEM AS A QUICK-FIX BORROWING SCHEME FOR DEFICIT REDUCTION.

WHEN WE CAST OUR VOTE TO ANSWER THIS QUESTION IT IS MY HOPE THAT WE WILL BE VOTING TO REMOVE THE TRUST FUNDS - WHETHER HIGHWAY OR SOCIAL SECURITY OR AVIATION - FROM THE COMPUTATION OF THE FEDERAL BUDGET DEFICIT AND ENACTING LONG TERM SOLUTIONS TO THIS CRITICAL ISSUE THAT AFFECTS SO MANY AMERICANS. THANK YOU.

Mr. CLINGER. Just a couple of questions, gentlemen. One of my concerns is the deterioration of the Nation's infrastructure and the fact that we are drawing down our capital at a rather alarming rate. Following up on Mrs. Bentley's question, it has been suggested that perhaps we should be devoting some of the surplus or the reserve that we have in Social Security to repairing the Nation's infrastructure, getting our transportation system in better shape—aviation and all the rest of it—with the idea being that to the extent that we are able to increase productivity in this country, make ourselves more competitive, and clearly the quality of infrastructure has a direct relationship to our ability to have sustained economic growth, that that would be the best insurance that we have for our babyboomers and others by having a very healthy, growing, expanding economy with people being able to pay into the system by virtue of the fact that we have maintained our capital base. Does that make any sense?

Mr. REISCHAUER. To be crude, no. Having gotten your attention with that answer I'll back off from my rude responses. The real issue here is not whether to take the Social Security trust funds and use them for infrastructure. It is how much the Federal Government is going to spend on investment.

First, if we simply took part of the Social Security funds and said, "These are available now for infrastructure investment," and then the Federal Government had to borrow more, we would be doing nothing at all to aggregate borrowing in the Nation.

Second, if we made Social Security funds available, you would have to make sure that those funds constituted net new investment and that State and local governments and others didn't reduce their own spending. It is really a terribly complex issue. I sympathize with the view that the U.S. Government can increase growth and productivity in ways beyond a simple reduction in the deficit. That is, by shifting the composition of existing government spending more toward investment in human capital, in R&D and technology, in infrastructure, and in various other ways.

These many ways might be as effective in increasing the size of the economy and preserving the opportunities for the baby boom generation as reducing the deficit. We ought to consider all of those ways.

Mr. CLINGER. So you support the goal, just not the—

Mr. REISCHAUER. Yes. I am just questioning whether the mechanism would produce the result you suggest.

Mr. ENOFF. Maybe I could be more positive. After we resolve the deficit problems and get to the point where there is no debt to buy, then certainly there is no reason that Social Security trust funds could not be invested in that regard as long as we have adequate protection.

Mr. CLINGER. Once we reach Mr. DeFazio's—

Mr. REISCHAUER. Another issue argued by many is, "Shouldn't we make these funds available to State and local governments?" State and local borrowing rates are considerably below what the Social Security Administration earns right now because of its tax-exempt status. It is inconceivable in my economic reasoning that the State of New York is going to say, "Give me a chance to get

some of that Social Security money at two percentage points higher than I can get down on Wall Street."

Chairman ROYBAL. Time has expired.

The Chair recognizes Mr. Ridge.

Mr. RIDGE. Thank you, Mr. Chairman. I would ask unanimous consent to submit a brief opening statement.

Chairman ROYBAL. Without objection, it will be the order.

[The prepared statement of Mr. Ridge follows:]

Statement by Congressman Tom Ridge-February 28, 1990

Subcommittee on Retirement Income and Employment-"Returning Social Security to Pay-As-You-Go Financing: Impact on Benefits and the Federal Budget Deficit.

I wish to commend the Chairman for holding this joint hearing on proposals to return the Social Security system to pay-as-you-go system.

The integrity of the Social Security system must remain intact for today and future generations. As the numbers of workers contributing to the system decline and the numbers of the beneficiaries increase, pay-as-you-go may threaten the stability of the system requiring benefit cuts or a significant tax increase to cover the shortfall. Other programs which are part of the Social Security face future financial problems, for example, the Medicare Hospital Insurance Trust Fund is expected to be in the red in just 10 years.

The Social Security Amendments passed by the Congress based on the recommendations of the 1981 National Commission on Social Security are working and there is a surplus in a system that was once on the brink of bankrupcy. The focus should be on maximizing the return on the surplus monies through a sound investment policy. Current investments are in non-marketable government securities. I am interested in modifying or expanding those investments to secure a higher rate of return.

Again, thank you Mr. Chairman, I look forward to hearing today's testimony.

Mr. RIDGE. Mr. Chairman, I just have a couple of practical questions to ask. You did mention that the tax is mildly regressive, and I think we all understand that. Someone once told me that those at the lower end of the income scale paying into Social Security get proportionately higher benefits, assuming they live to be a median age. Is that accurate?

Mr. ENOFF. That's absolutely correct. The benefit formula is skewed to take account of the lower-wage earner needing a higher percentage of return.

Mr. RIDGE. It more than offsets the—

Mr. ENOFF. Regressive, if you want to call it regressive.

Mr. RIDGE. I don't like calling it regressive either.

Mr. ENOFF. I don't know if you were here when we talked about it, but we need to, I think, talk about the social insurance system as a whole, not about the tax and forget about the benefits that include benefits for workers that become disabled, for survivors, and for family members. That's not considered when you talk about a tax.

Mr. REISCHAUER. A lot of redistribution goes on in the Social Security system, and some of it relates quite clearly to income levels or earning levels. But others, such as the spouse benefit, cause great redistribution between individuals at all income levels.

Mr. ENOFF. I was just going to say that Social Security benefits are based on 90 percent of the first $356 of average indexed monthly earnings and it goes down to 15 percent when you get above $2,142, so that's the way the benefit formula is structured to provide that high return for the lower level.

Mr. RIDGE. The debate anticipated by senators opposed for having this hearing clearly has brought to the floor not only Social Security, but the whole question of the deficit. In responding to the questions of Mrs. Bentley and Mr. Clinger, you alluded to using what might be considered on paper as surplus for other ventures. Neither one of you were very enthusiastic to that approach. I can understand why because ultimately the confidence of the people in the system is something that has been badly shaken by politicians, I might add, from time to time over the years. We have to be careful about eroding that confidence that is so important.

The law, as I understand it, limits the investment of surplus into government securities. Do you have any reason to believe that giving the proper authority to the appropriate people who have been investing part of that into private sector would jeopardize that confidence and trust?

Mr. ENOFF. I would hesitate at this time. This is the safest investment there is. When you say "a part," what are you talking about and when? I think it is safe; it has been proven safe over 50 years. At this point in time, I would not see a need to—

Mr. REISCHAUER. This opens a real can of worms and could politicize the investment policy. Let me give two simple examples. What if the trust fund owned a lot of Nabisco bonds, and then along comes the RJR leveraged buyout, which ended up causing large capital losses for bond holders? Would you sit back and say, "That's the way the free market works. We aren't going to be involved in this issue of leveraged buyouts."

Here is my second example: what would happen if the companies in which you held your securities began investing in countries that suggested policies, such as apartheid or genocide, abhorrent to the vast majority of the Congress? Would you pressure the Social Security Administration to change its investments? What about issues of corporate governance? These are very difficult things. We have a very good system right now. I would stick with it.

Chairman ROYBAL. The time of the gentleman has expired.

Mr. RIDGE. Thank you, Mr. Chairman.

Chairman ROYBAL. The Chair recognizes Mrs. Schneider at this point and then followed by Mr. Pallone.

Mrs. SCHNEIDER. Thank you, Mr. Chairman.

You had touched on states' savings rates, what is your perspective on Social Security and its relationship to the national savings rate? Would a pay-as-you-go approach improve or erode the future national savings?

Mr. ENOFF. I think you addressed that. Maybe you would want—

Mr. REISCHAUER. If we reverted to a pay-as-you-go system, we would be cutting the payroll tax, cutting revenues coming into the Federal Government, and increasing the overall deficit of the Federal Government, which is a form of dissaving. In and of itself, that would lead to a lower overall national saving rate.

If many people felt the way Mr. DeFazio felt and became nervous that there would be no Social Security for them when they retired and, consequently, boosted their personal saving rate, then you might get some tiny offset. But I don't believe it. I think we should assume that there would be a substantial fall in national saving.

Mrs. SCHNEIDER. I have no further questions, Mr. Chairman.

Chairman ROYBAL. Thank you.

Mr. Pallone.

Mr. PALLONE. Thank you, Mr. Chairman. I came in late, and I haven't listened to any of your testimony, so I may be asking something that has already been established. I just wanted to know, did you present or do you have any figures in terms of what this surplus is expected to build up to over the next few years, and at what point it would start being drawn down? In other words, a lot of the questions about how to change things and where we're going with this, it seems to me, would depend on what the life of the system is and the amount of money that we're actually going to raise. I was wondering if you had commented on that at all.

Mr. ENOFF. I think we have. Even the charts do depict that. Under the 1989 Trustees Report, alternative IIB, we would continue to build reserves until we reach $12 trillion in about 2030. But except for interest, we would begin spending more than we would be taking in, so to speak, around 2018.

Mr. PALLONE. In your initial assumptions that were established in terms of increasing the payroll tax, I guess back in 1983 when this new system was enacted, your initial assumptions about how much money we would need, and what that buildup would be, and how it would be drawn down, they still are the same? There hasn't been any change?

Mr. ENOFF. Well, actually the financing schedule, as we talked about earlier, was changed in 1977. The rates were accelerated a little in 1983. What has happened is that the economy has per-

formed so very well in the past 7 years that the reserves have built more than was anticipated then. We are still only at a 9 month reserve ratio, and I think in the discussion here earlier we have said we should be at 150 percent, at least 100 percent, and we have some time in the future until we reach that.

Mr. PALLONE. Okay. Thank you, Mr. Chairman.

Chairman ROYBAL. Thank you.

The committee would like to thank you for your testimony. There will be some questions that will be submitted to you in writing. We sincerely hope that you will answer those questions as soon as possible.

I have 2 or 3 questions and, no doubt, others also have questions.

Thank you, and I sincerely hope that when the report is written, you will find it to be somewhat favorable.

The next panel will be made up of Mr. Robert J. Myers, Mr. Robert M. Ball, and Mr. Gary Burtless. Please take your respective seats, and I'll ask you to proceed as soon as possible.

## STATEMENTS OF ROBERT J. MYERS, FORMER CHIEF ACTUARY OF SOCIAL SECURITY; ROBERT M. BALL, FORMER COMMISSIONER OF SOCIAL SECURITY, AND CHAIR, NATIONAL ACADEMY OF SOCIAL INSURANCE; AND GARY BURTLESS, SENIOR FELLOW, THE BROOKINGS INSTITUTION

### STATEMENT OF ROBERT J. MYERS

Mr. MYERS. Thank you, Mr. Chairman. I am very glad, as always, to appear before your committee and to discuss Social Security matters with you.

First, I would like to give a brief summary of the experience of the system, both as it has been in the past and as it is estimated to be in the future, according to the intermediate estimates.

Chairman ROYBAL. Can we ask then that your written statement be included in the record?

Mr. MYERS. Yes, if you please, Mr. Chairman.

Chairman ROYBAL. All right. Please proceed.

Mr. MYERS. At the end of 1988, the assets in the Social Security trust funds were $110 billion, and at the end of 1989, they were $162 billion. The assets at the end of 1988 were $71 billion higher than they were estimated to be at that time when the 1983 legislation was enacted. In other words, the fund was three times as high as it had been estimated.

Admittedly, the estimate that I am referring to was a pessimistic estimate, because the National Commission on Social Security Reform and the Congress wanted to be certain that the system would not have another crisis in the 1980s. It most surely has not. Accordingly, the estimates were made under pessimistic economic assumptions, where as the experience was quite favorable.

In 1990, there will be an excess of tax income over outgo of some $70 billion, and these annual excesses—some people call them surpluses—will increase gradually until they will be $125 billion in 1995 and $200 billion in the year 2000.

The trust fund size, as is shown by one of your excellent charts will increase very rapidly in the 1990s. I should mention that there has been quite a bit of discussion here today about the trust fund

ratios. In other words, how large the trust fund is at any time as compared to the expected annual outgo.

At the end of last year, or at the beginning of this year, that ratio was 75 percent. That figure has been widely quoted. One very important figure has not been quoted. At the end of this year, that trust fund ratio will reach 100 percent which, to some people, is the lower limit of what is needed to be safe on a contingency basis. As I will get into a little later, I think that 100 percent is adequate for any depression that there might be.

To get on with the discussion of the experience, the trust fund will build up to $7.2 trillion in the year 2015, which is $2.6 trillion in terms of today's dollars. At that time, the trust fund will be 5½ times the annual outgo. But then, the roller coaster will start, and the trust fund ratio will begin to decrease. In 2030, the fund balance will reach a nominal height of $11.9 trillion, but then, in 15 years, it will be exhausted.

I assert that this is no way to run any sort of a pension plan or a social insurance system—to expect to build up a huge fund and then have it vanish. Even under the pessimistic estimates, the trust fund will build up over the next 25 years, and in the year 2015 it will be $3.3 trillion. Of course, it will be exhausted much sooner than the year 2046 as shown by the chart. It probably would be exhausted in about 2025.

What happens when the trust fund is exhausted? Either at that point benefits have to be reduced or, if the same benefit structure is to be maintained, the tax rates have to be increased. In other words, once the trust fund is exhausted, the program is on a pay-as-you-go basis. Under the estimate to which I am referring, the tax rate would have to be increased by 2 percent each for the employer and the employee in 2046, which I think is not an overwhelmingly large increase, and which I think could be managed, but it would be a rather sharp jolt if it were done all at one time.

I believe very strongly that Social Security should be returned to a pay-as-you-go system as it was in the early 1970s and for several decades before that. I think that Senator Moynihan's bill is just the right way to go. I think that it is better for the system. I think that it is better for the beneficiaries. I think that it is better for the Nation.

The reason that I say that is because there are certain dangers associated with building up a large trust fund balance. The first one is that, as the other chart shows, this distorts and hides the horrendous budget deficits that the Nation has, which are really somewhat over $200 billion a year and gradually increasing. Including the operations of the Social Security trust funds in the Gramm-Rudman target calculations makes it look as though the budget problems are being solved, when they really are not.

This difficulty, of course, can be solved, as a number of people have suggested today, by taking the operations of the Social Security system out of the Gramm-Rudman targets.

There are two other difficulties that I would see anyhow. One is that with the Social Security system having so much money to invest each year, it makes it very easy for the Treasury to borrow the money, because automatically the trust funds must give the money to the Secretary of the Treasury and get Government bonds

in return. I am not saying that Government bonds are not good investments, but it is so easy to borrow money that way that the Administration and the Congress might not be as frugal as they would otherwise be.

The third reason why I believe that a large trust fund is undesirable is that when the fund gets up to be hundreds of billions of dollars or trillions of dollars, the political pressure from the beneficiaries to increase benefits in an irresponsible manner would be irresistible in the next 10 to 20 years. They will say, "Look, you have billions, trillions of dollars there. Why not give us a 10 percent or a 20 percent increase? The money is there." They think of it as being there in dollar bills, and they also say, "You've got more money coming in that you need this year; give us just a little larger benefits."

The problem then is that when the baby boomers come along to retirement age, and the financing problems become that much more difficult, it will not be possible to reduce benefits. I think that in creating that big pot of money, there would be very, very serious dangers, because beneficiaries would exert great pressure on Congress and the Administration to increase benefits irresponsibly.

Next, I will talk briefly about what was the intention of the National Commission on Social Security Reform in 1983. It was not to shift from pay-as-you-go financing, which actually we did not have at that time, to this roller-coaster financing procedure of building up a big fund and then using it up. It should be noted that, if there were just a closed group, and we were only taking care of the babyboomers, a fund could be built up and then used up for them, but the fact is that the cost of the system as a percentage of payroll will be just as high after the babyboomers pass from the scene as it is when they are at the retiring ages. So, it is not a question of a decreasing cost over time, but rather it is an increasing cost.

I think that if the record is examined, both of the National Commission and its report and of the Congress and the debate in 1983, there was not a single word about building up a large fund for the babyboomers. Instead, what was the big concern then was that the system was going to go bankrupt in the middle of 1983, by which I mean that there would not have been enough money in the fund to send the benefits checks out in a timely manner. Instead, the emphasis then was to avoid another financial crisis in the next few years, and that was certainly done.

The Congress and the National Commission responsibly said, "Let's look at the long range; we have a long-range deficit on the average. Let's solve it." Therefore, it was solved on the average, but the year-by-year picture was not looked at. There just was not the time to do it, considering how difficult it was to obtain a consensus at that time.

The effect of the legislative changes was to have the system in long-range balance and to show the intent of Congress that it was concerned with long-range issues, but they did not go into the year-by-year picture. I would say that, if pay-as-you-go financing is adopted now, this is not unraveling the agreement that was made in 1983. This is merely fine tuning the financing, because under present law, that is what will occur eventually. So, why not do it now?

If the Moynihan proposal were to pass, as I hope that it will, I believe that Social Security benefits would not be jeopardized in either the short term or the long term. I believe that beneficiaries would feel more confident in the system, not less confident. At the moment, I think that there is a great weakening of confidence when people talk about the funds being embezzled and being spent for other things. If there were not a big fund, you would no be that criticism.

Some people say, "Suppose that there is a fund of only one year's outgo would not that be dangerously low?" As I said, there is that size of fund now. If a change in the tax rate were effective next year, there would be a 100 percent fund ratio then. In my actuarial opinion, a rating of 150 percent is not necessary for safety's sake. Some people say, "Look what happened when the 1977 amendments were enacted. Everything was going to be fine, and yet a crisis occurred 5 years later." There is a big difference. In 1977, the fund ratio was only 50 percent, not 100 percent, as it is now.

Second, there was no stabilizer in the law, as there is now, that alleviates the situation when economic conditions are poor. In present law, as you know, as a result of the 1983 Amendments, if prices increase more rapidly than wages, the cost-of-living adjustments will be the lower of the two increases if the fund is low. That was the bad condition that happened in the early 1980s. Prices went up so much more than wages. So I say that, if those two things had been in effect in 1977—a good stabilizer provision, and a fund ratio of 100 percent—there would not have been the crisis which occurred in the early 1980s.

Another thing the people say is "If Senator Moynihan's tax schedule were enacted, suppose that conditions turn out poorly, and Alterative 3, the pessimistic estimate, occurs. In 1999, the fund will be bankrupt again." The answer to that criticism is that, "With responsible pay-as-you-go financing, a tax schedule is put in the law and forgotten about. Every 2 or 3 years, or even every year, the financial situation will be examined carefully. If the experience gradually got worse, by the time that the fund ratio dropped from the current 100 percent down to, say, 60 percent, something would be done about it. The tax rate would be raised back up again, maybe not as high as in present law, but at least above what the pay-as-you-go that was enacted schedule would be. So, I maintain that pay-as-you-go financing can be fiscally responsible and can be accomplished in the way that Senator Moynihan suggests.

Finally, let me address the point that has been raised about having more active management of the assets of the trust funds. I believe that the present basis of an automatic procedure is necessary when there are such large amounts of money involved. Even under pay-as-you-go financing, there are still large amounts. I think that there should be no attempt to outmanage the rest of the investment market.

Certainly, as Mr. Reischauer said, the trust funds should not go into State and municipal bonds, because of the lower interest rates. As to getting into Ginny Mae's and Fannie Mae's, I think that this would be too much managing of a fund that could have an impact on the general operations of the market.

The only thing that I would suggest is what the National Commission recommended as to a change in the existing automatic investment procedure. I think that was a good idea. Interestingly, both the House bill and the Senate bill in 1983 adopted this provision. Yet, in conference, it was dropped, which was a rather unusual procedure because, as you know, when a provision is in both the House and the Senate bills, it usually is not touched in conference.

This provision was merely that the investments, instead of being in long-term bonds with various maturities, would be in a money-market type of account, but with the interest rate being the average interest rate for long-term Government obligations. This would not produce much difference in the financing, but it would make it clearer to people what the interest basis was—namely, that it changes with the current market rates.

In 1983, there was much criticism because the trust funds held some bonds that were only bearing 4 or 5 percent interest. At that time, anybody could get 13 percent on new issues. As for any other investor, the trust funds had held those bonds for years. What I would recommend is to make the bonds, in essence, roll over every month, but have the interest be payable at a long-term interest rate, which is generally higher than a short-term rate.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Myers and answers to written questions submitted by Chairman Hughes and Mrs. Lloyd follow:]

STATEMENT BY ROBERT J. MYERS TO THE SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT, SELECT COMMITTEE ON AGING, HOUSE OF REPRESENTATIVES, FEBRUARY 28, 1990

Mr. Chairman and Members of the Subcommittee: My name is Robert J. Myers. I served in various actuarial capacities with the Social Security Administration and its predecessor agencies during 1934-70, being Chief Actuary for the last 23 of those years. In 1981-82, I was Deputy Commissioner of Social Security, and in 1982-83, I was Executive Director of the National Commission on Social Security Reform. Currently, I am Chairman of the Commission on Railroad Retirement Reform.

This testimony will first deal with the present financial status of the Social Security program -- Old-Age, Survivors, and Disability Insurance (OASDI) as shown by the 1989 Trustees Report. I shall also discuss the problems that I see with the manner in which OASDI is being financed and funded under present law and why a return to a pay-as-you-go financing procedure would be desirable. Such problems relate both to the program itself and to the general budgetary situation of the Federal Government.

## Present Financial Status of OASDI Program

The OASDI system is currently in excellent financial health. The assets of the OASDI Trust Funds at the end of 1989 amounted to $162 billion (and were $110 billion at the end of 1988). The fund at end of 1988 was $71 billion higher than was estimated for that date in the pessimistic (Alternative III) estimate made when the 1983 Amendments were enacted -- on which estimate the short-range financing (for the 1980s) was founded in the legislation. Such excess of actual over estimated fund balance was $51 billion for the intermediate (Alternative II-B) estimate.

Under current law, large annual excesses of income over outgo -- which cannot properly be referred to as "surpluses" -- develop in the next three decades under OASDI. Such excesses, under the intermediate estimate, amount to about $70 billion in 1990, and increasingly larger amounts thereafter (e.g., $125 billion in 1995 and $200 billion in 2000). As a result,very large fund balances will be built up during the next four decades. The fund ratio -- which is the fund balance at the beginning of the year expressed as a percentage of that year's outgo -- peaks at 546% in 2015, when it is estimated at $7.2 trillion in current dollars, or $2.6 trillion in 1989 dollars. After 2015, the fund balance continues to grow in terms of current dollars, reaching a peak of $12 trillion in 2030. Under the pessimistic assumptions, the fund balance in 2015 is $3.3 trillion in current dollars, or $0.9 trillion in 1989 dollars.

After the end of the build-up period, the assets of the trust funds will be drawn upon, and, under the intermediate estimate, they will be exhausted in 2046. At that time -- if the benefit provisions are left unchanged -- additional financing in the form of higher payroll tax rates will be necessary. These increases would, on the basis of the intermediate-cost estimate, be 2.0% for both the employer and the employee over the rate now in effect for 1990 and after -- not an unmanageable rise.

No legislative intent has seemed to have been present, or expressed, to change over to this funding basis from the current-cost approach adopted in 1972 and supported over the subsequent years by the Board of Trustees. I am constrained to say that this procedure of building up a mammoth fund balance and then depleting it does not make good sense, especially when the program's cost (as a percentage of taxable payroll) is just as high in all years after 2030 as it is then.

## Relationship of OASDI to [illegible] Budget

The manner in which, under present law, the OASDI Trust Funds first build up huge amounts in the next four decades and then decrease over the next two decades until being exhausted would have significant, deleterious effects on public-debt management and on Budget operations.

The relationship between the operations of the OASDI Trust Funds and the Budget is frequently misunderstood by the general public. Beginning in fiscal year 1986, the operations of the OASDI Trust Funds have been out of the Unified Budget, so that any excess of their income over outgo does not reduce the Budget deficit. However, anomalously, these trust-fund excesses of income over outgo are counted to meet the Gramm-Rudman-Hollings targets for Budget-deficit reduction. The result is thus virtually the same as if these trust-fund operations were included in the Budget, but the imbalance is really still there, and the National Debt is increased by the amount of the trust-fund excesses of income over outgo. In other words, the result of this procedure is, in the short run, to make the targets easier to meet and thus to make the Budget deficits appear smaller than they really are.

## Widespread Fallacies about Financing Basis of OASDI

One myth is that the National Commission on Social Security Reform, in its recommendations which led to the 1983 Amendments, intended to have the system accumulate a huge fund while the baby boomers are employed, and then draw it down.

This was by no means the thinking of the Commission when it made its recommendations. Nor was it the intention of Congress when the legislation was enacted. No reference to any such intention can be found in the Commission's report or in the congressional debate.

Moreover, the information about the huge growth in the trust-fund balances had not been available when the Commission made its consensus recommendation, or even to Congress later when considering the legislation. Such figures were actually not available until mid-1983, although those with actuarial knowledge realized earlier that the approach taken would result in trust-fund buildups.

The Commission developed its recommendations by ensuring, as much as possible, that the year-by-year financing in the 1980s would be adequate and that, over the long range and on the average, sufficient financing would be provided. As is well known, the use of averages can be deceptive. That certainly is the case in this situation, as compared with looking at the year-by-year development of the trust-fund balances over the long run.

Accordingly, the building up of a huge fund that would peak in the midst of the baby boomers' retirement was a coincidence -- or, at most, an unintended by-product of the recommendations.

## Various Methods of Funding OASDI

Next, I will briefly discuss the advantages and disadvantages of current-cost funding as against advance funding (either full-reserve or partial-reserve) for benefit systems with rising relative costs over the years, when considered as percentages of taxable payroll. The discussion thus applies to systems like OASDI. By current-cost, or pay-as-you-go, financing is meant that, on the whole, income will approximately equal outgo each year. Under this approach, a fund would be built up and maintained that would be approximately 6 - 12 months of outgo. Such a contingency reserve would be utilized to finance the system when business recessions temporarily reduce tax contribution income. It would then be built up again during times of economic recovery.



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Certain matters in connection with funding relating to plans of individual employers (especially non-governmental ones) are not applicable to national social insurance systems -- for example, the possibility of going out of business or of not having new entrants. The following discussion will relate only to the OASDI system.

The advantage of full-reserve funding -- and, similarly, to a considerable extent, of partial-reserve funding -- is simply that thereby the contribution rate ultimately will be lower than it would be under current-cost funding. This occurs because the interest on the assets accumulated from the excess of income over outgo in the early years of operation is available to meet the outgo. Assuming that the assets of the OASDI Trust Funds are invested in government-debt obligations (as seems to be the only proper procedure), the resulting interest income is "valid". If these obligations were not held by OASDI, they would have been held by the general public, and the same interest on them would have been paid.

It could be argued that the higher contribution rates in the early years, and the lower ones later, under full- or partial-reserve financing would result in greater intergenerational equity. This is so because the initial covered population, especially those near retirement, receive "windfalls" (as measured by considering the value of their benefits as against the contributions paid by them or on their behalf) as compared with the situation for young new entrants. Accordingly, a level contribution rate (or, even, a higher rate in the early years than later) -- as might be provided under a full- or partial-reserve funding approach -- would alleviate the situation.

The disadvantages advanced against full- or partial-reserve funding are more of a "political" nature than of a theoretical, actuarial nature. One problem would result from the huge amounts of investments involved, which could absorb a very large portion of the National Debt (or even all of it) and thus not leave sufficient for the general investment market. Another problem might be that the ready availability of large amounts of money that could easily be borrowed by the General Fund of the Treasury would encourage excessive governmental spending.

Yet another problem is that the presence of a very large fund balance could create politically irresistible demands for greatly liberalized benefits on the grounds that "all that money is there". The difficulty, then, if such liberalization did occur, and the fund balance were drawn down, would be that the OASDI costs in future years would be greatly increased over those under present law -- and the long-range financing problems would become greater.

Actual Funding Basis of the OASDI Program

Next, I will take up the subject of how OASDI has been funded over the years. The original system (1935 Act) was funded on a partial-reserve basis -- and not on a fully-funded basis, as sometimes alleged. The 1939 Act, which expanded the program to include auxiliary and survivor benefits, was also funded on a partial-reserve basis -- and did not institute current-cost funding, as is often erroneously stated. However, the system was then funded at a lower relative level than under the 1935 Act.

During the 1960s and 1970s, the emerging experience of OASDI was such that the funding was actually on a more or less current-cost basis. However, until 1972, the funding basis as to the estimated future experience was still on a "partial-reserve" basis. The 1972 Act introduced the concept of current-cost funding over the long range, but the 1977 Act (and the 1983 Act as well) did not follow this principle, but rather resulted in the build-up of a mammoth fund balance -- and then its depletion before the end of the 75-year valuation period.

## Views of J. Douglas Brown on OASDI Financing

Dean J. Douglas Brown of Princeton University, who was one of the leaders in the initiation of the OASDI program and in its subsequent development over the years, said cogent words about the necessity for not distorting the OASDI system by making it become an instrument of fiscal policy. In his book "An American Philosophy of Social Security" (Princeton University Press, 1972), he stated:

> "It has been strongly urged by succeeding Advisory Councils that this posture of neutrality be maintained despite the growth of social insurance income and disbursements. The repeated recommendation that the size of the reserve be kept as close as possible to one year's benefit payments is based, in large part, on this concept of neutrality. Pronounced changes in social security reserves through unwise planning of contribution schedules or benefit disbursements were to be avoided to limit any inflationary or deflationary effects on the general economy. Advisory Councils have likewise urged that the fiscal agencies of the government avoid any tendency to interfere in the determination of social security policy for the ulterior purpose of easing their current fiscal problems. This trade-off of neutrality on the part of two major agencies of government which deal with large flows of funds in respect to each other's policies is of great importance in maintaining the integrity of the American social insurance system. If the system became an instrument of fiscal policy, the precious confidence of the American people would be undermined. The system in its own normal operations provides a stabilizing factor in the American economy. But its primary purpose is to provide security to the individual American worker and his family. It should not be distorted into a mechanism for the manipulation of fiscal balances."

## Desirable Changes in Financing of OASDI Program

I believe that the financing basis of the OASDI program should immediately be changed back to the pay-as-you-go basis that has been followed, in effect, for the past few decades. This would be accomplished admirably by Senator Moynihan's bill. The fund ratio of the OASDI Trust Funds at the end of this year will be very close to 100%, which, in my actuarial opinion, is adequate for pay-as-you-go financing to be viable.

I well recognize that the actual experience over long-range periods will not necessarily follow the intermediate assumptions. This, however, does not create any problem, because the contribution schedule will necessarily, in any event, need to be re-examined from time to time as the experience unfolds. Then, adjustments in the schedule -- either upward or downward -- can readily be made.

Some individuals have asserted that pay-as-you-go financing will mean permanently higher tax rates over the long run than under present law. They base this viewpoint on the fact that the ultimate tax rate for both employers and employees under Senator Moynihan's bill is 8.1%, as against the 6.2% scheduled under present law for all future years. However, they forget that, under present law, once the fund balance has been depleted (in some 55 years, under the intermediate estimate), the contribution rate must increase to the same 8.1% as under pay-as-you-go financing if the benefit provisions remain unchanged. In other words, if OASDI is financed on a pay-as-you-go basis as in Senator Moynihan's bill, payroll tax rates would be lower than now scheduled for the next 25 years, the same for the next 5 years, and somewhat higher for the following 25 years, but the eventual rates ultimately will be about the same.

Some people have expressed the fear that benefits are more likely to be reduced under pay-as-you-go financing than under the present "roller coaster" financing method. This is not at all likely to be the case because, as just indicated, the tax rates under pay-as-you-go financing are not all that different from what would have to be done under present law. In essence, changing to pay-as-you-go financing is not a drastic change in direction for the Social Security program or an abandonment of the consensus reached in connection with the 1983 Amendments. Rather, it is merely a fine tuning of the financing procedures.

I believe that pay-as-you-go financing would increase public confidence in the OASDI program. No longer would there be the confusion and the fear of "thievery" and "embezzlement" in connection with the use of trust-fund monies to balance the budget.

Some people also question whether the level of the OASDI Trust Funds -- at about 100% of annual outgo currently, as well as estimated to be the case over the 75-year valuation period, as shown by the accompanying chart, prepared by the Office of the Actuary, Social Security Administration -- would be adequate if poor economic conditions should occur. It should be recognized that, under such circumstances, the contribution rates could be increased somewhat to provide the necessary financing (and still be lower during the next two decades than under present law).

A further safeguard under such economic circumstances is the stabilizer provision already in law, which provides for the Cost-of-Living Adjustments to be the smaller of wage increases or price increases when the fund ratio is low (under 20%). This provision is certainly equitable to the beneficiaries, because one can well argue that their COLAs should not be larger than the wage increases given to the workers who are currently making contributions to support the system. At the same time, any part of the COLA which is "lost" when wages increase less than prices is desirably restored when the normal situation of wages rising more rapidly than prices again occurs (and the fund ratio is substantially higher -- over 32%). It is my belief that this existing provision should be changed so that the trigger level is somewhat higher than a fund ratio as low as 20%, and that certain technical changes in it are desirable for consistency and comparability.

The Role of OASDI Operations in the Gramm-Rudman-Hollings Targets

In my view, the operations of the OASDI program should be removed from the computation of the Gramm-Rudman-Hollings targets for the Budget deficit reductions. The deficit situation would then be portrayed vividly and honestly. However, if we go to pay-as-you-go financing, as under Senator Moynihan's bill, this question becomes relatively moot, because the targets would be only minimally affected whether or not the OASDI operations were so included.

Some people believe in the large build-up of the OASDI Trust Funds for budgetary reasons and/or for encouraging greater savings efforts in our nation. This is despite the good reasons against having the Social Security program distorted to become a mechanism for the manipulation of fiscal affairs, as Dean Brown so sagely warned against. I might say -- not entirely facetiously -- that if this use of the program is so desirable, then why not increase the contribution rates and build up even larger fund balances, so that the program is more nearly actuarially fully funded, as ERISA requires private pension plans to do.

## Investment Procedures for OASDI Trust Funds

The assets of the OASDI Trust Funds are invested by the Secretary of the Treasury solely in U.S. government obligations, except for a relatively small cash working balance. The securities can be of any of three types -- obligations bought on the open market, obligations bought at issue (as part of a new issue offered to the public), and special issues. In the actual operations in the past, almost all of the investments have been in special issues. The law provides that the special issues shall bear an interest rate equal to the average market yield rate on all U.S. government obligations with at least 4 years to go until earliest maturity (as of the issuance date of the special issue), rounded to the nearest 1/8%. No specific provision applies as to the period until maturity for the special issues, but in practice, it is attempted to have them in a maturity schedule spread equally over a period of 15 years. Investment is also permitted in debt obligations that are guaranteed as to both principal and interest by the U.S. government, such as those of the Government National Mortgage Association.

At the time of the 1983 Amendments, both the House and Senate versions of the bill contained provisions for significantly revising the investment procedures. The proposed procedure, which had been recommended by the National Coumisssion on Social Security Reform, would have been similar to money-market funds with varying market interest rates each month, with such rates being determined on the same basis as had been previously foilowed (and still is).

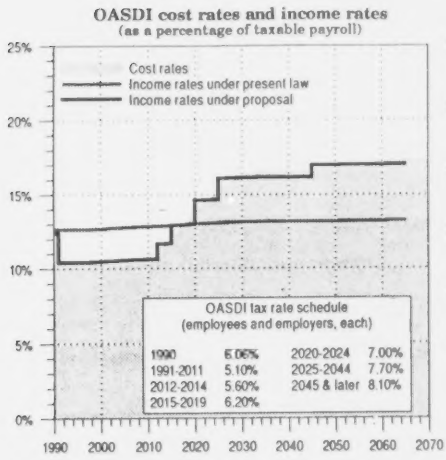
This revised investment procedure would have added to the general public's understanding of the investment situation. Over the long run, it would probably have had a neutral cost effect. The proposed new basis was dropped in the joint conference between the House and the Senate, because of the belief that there would be a declining trend in interest rates in the next few years. If that occurred, the trust funds would have lower investment returns than under the old procedure.

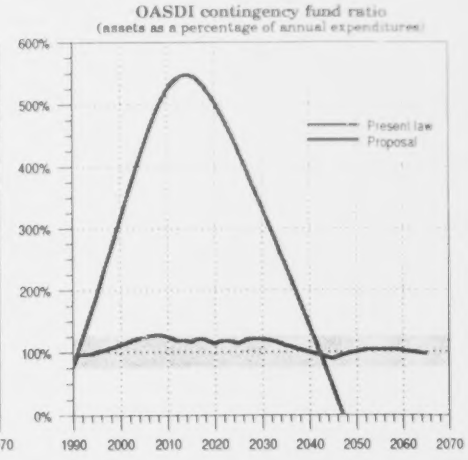
It has sometimes been suggested that there should be more freedom in the investment procedures for the trust funds, such as active asset management and investment in government-agency instruments (e.g., Fannie Mae), state and municipal bonds, and stocks and bonds of private companies. I believe that, considering the nature of the trust funds and their large size (even under pay-as-you-go financing), anything but an automatic investment procedure would be undesirable. The guiding priciple in this respect, as well as in other fiscal ones, should be neutrality of effect.

## Conclusion

In summary, the time has arrived when the financing of the OASDI program should be rationalized, stabilized, and made crystal clear by going to a pay-as-you-go basis, as proposed by Senator Moynihan. The system would then be financed on a clear, visible, and understandable basis, and would be actuarially sound. Such a change would not endanger the benefit rights of either current beneficiaries or those who will come on the rolls over the long-run future. At the same time, this would give the nation a better and clearer opportunity to solve the problems with the Budget and with the savings capacity of its citizens.

## Projected OASDI Financial Operations Under Senator Moynihan's Bill, S. 2016, As Introduced




| Calendar year | Income rate | Cost rate | Balance | Contingency fund ratio |
|---|---|---|---|---|
| 1990 | 12.35% | 10.52% | 1.83% | 77% |
| 1991 | 10.40 | 10.55 | -.15 | 94 |
| 1992 | 10.41 | 10.58 | -.17 | 96 |
| 1993 | 10.41 | 10.57 | -.15 | 96 |
| 1994 | 10.41 | 10.51 | -.10 | 97 |
| 1995 | 10.41 | 10.45 | -.03 | 99 |
| 1996 | 10.41 | 10.40 | .01 | 101 |
| 1997 | 10.41 | 10.35 | .06 | 103 |
| 1998 | 10.41 | 10.32 | .09 | 106 |
| 1999 | 10.44 | 10.31 | .12 | 108 |
| 2000 | 10.45 | 10.28 | .17 | 111 |
| 2005 | 10.54 | 10.26 | .28 | 123 |
| 2010 | 10.61 | 10.76 | -.16 | 124 |
| 2015 | 12.88 | 12.03 | .85 | 115 |
| 2020 | 14.57 | 13.70 | .87 | 112 |
| 2025 | 16.06 | 15.22 | .83 | 113 |
| 2030 | 16.11 | 16.22 | -.11 | 120 |
| 2035 | 16.14 | 16.60 | -.46 | 110 |
| 2040 | 16.15 | 16.57 | -.42 | 99 |
| 2045 | 16.95 | 16.56 | .40 | 89 |
| 2050 | 16.96 | 16.73 | .23 | 99 |
| 2055 | 16.98 | 17.00 | -.02 | 103 |
| 2060 | 16.99 | 17.19 | -.19 | 101 |
| 2065 | 17.00 | 17.29 | -.29 | 96 |

| Period | Summarized income rate | Summarized cost rate | Summarized balance | Alternative balance |
|---|---|---|---|---|
| 1989-2013 | 10.68% | 10.53% | 0.15% | - - - |
| 2014-2038 | 14.92 | 14.90 | .02 | - - - |
| 2039-2063 | 16.79 | 16.86 | -.07 | - - - |
| 1989-2063* | 13.85 | 13.70 | .15 | -0.01% |

* Summarized income rate, balance, and alternative balance for 1989-2063 include beginning trust fund assets. Alternative balance also reflects requirement for ending fund assets equal to 100 percent of annual expenditures.

Note: Estimates are based on the alternative II-B assumptions from the 1989 OASDI Trustees Report.

Office of the Actuary
February 1, 1990

ROBERT J. MYERS
9510 WIRE AVENUE
SILVER SPRING, MARYLAND 20901

ANSWERS TO QUESTIONS FROM CHAIRMAN WILLIAM J. HUGHES

Question 1. "Do you believe that non-Social Security taxes are too low to pay for non-Social Security spending?

Yes. An equal amount of increased non-Social Security taxes decreases the Government's debt, whereas Social Security taxes merely defer the payment of that amount of debt to the long-distant future.

Question 2. "Is it possible to 'save' the trust funds exclusively for the retirement of the baby-boom generation: If so, how? And if not, why are we building a very large reserve of government-insured securities?"

Yes, it is possible (although, I believe, undesirable for other reasons) to "save" for the future through trust-fund investments in government bonds (regardless of how the money used to buy these bonds is spent -- which nobody can really know how this is done). The result of such procedure is such that payroll taxes can be lower in some far-distant future years, but at the same time, other taxes will have to be correspondingly higher in order to redeem the bonds sold by the trust funds (or new bonds will have to be sold to obtain the necessary monies).

Question 3. "Could you please explain the eventual tax rate increases scheduled under S. 2016, compared to the ones that are not scheduled under present law, but in your estimation, will be necessary?

Let us assume that the intermediate-cost estimate accurately portrays the future experience of the Social Security program and that the benefit provisions will remain unchanged. Then, the tax rate under present law in 2045 and after (when the trust funds have become exhausted -- after peaking at $12 trillion in 2030) will have to be increased so as to be the same as under S.2016 (or possibly slightly higher if the fund balance had been allowed to fall below one year's outgo). The reason is that, at such time, the financing basis of present law will have evolved into pay-as-you-go financing (because little, if any, fund balance will be present.

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FELLOW, CASUALTY ACTUARIAL SOCIETY
MEMBER, AMERICAN ACADEMY OF ACTUARIES
FELLOW, CONFERENCE OF ACTUARIES IN PUBLIC PRACTICE
MEMBER, INTERNATIONAL ASSOCIATION OF CONSULTING ACTUARIES
MEMBER, INTERNATIONAL ACTUARIAL ASSOCIATION

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ANSWERS TO QUESTIONS FROM REPRESENTATIVE MARILYN LLOYD:

Question 1. "Many experts estimate that the Medicare Hospital Insurance (HI) trust fund will run into great difficulties in the near future. Should the Social Security trust fund surplus be used to fund any shortfalls in the HI trust fund? Would that be possible under our current approach to spending Social Security surpluses?"

The HI Trust Fund will almost certainly have financial difficulties in about 10 years (possibly somewhat sooner). I believe that the financing of the HI and Social Security systems should be completely separate and independent of each other. It would not be desirable to provide for loans from the Social Security trust funds to the HI Trust Fund, because there would be no conceivable way that the loans could be repaid over the long run.

Under present law, there is no way -- nor should there be -- for the Social Security trust funds to give monies to the HI Trust Fund. The solution to the problem that is posed is to revise the tax-rate schedule for the Social Security program so that it is on a pay-as-you-go financing basis; then, when HI has financing problems, they should be solved by increasing the tax rates (and/or adjusting the benefit provisions).

Question 2. "In my opening remarks I referred to the Social Security dilemma as an intergenerational issue -- important to young and old. Would you agree, and if so, how do you thing that we can bring the non-elderly generations into this important discussion?"

Naturally, I agree that the situation as to the Social Security program is important to both the young and the old -- although I do not see that any real dilemma is involved. Moreover, I do not believe that one can separate discussants and participants into fixed generational categories, because they are continually shifting. I believe that there already is adequate discussion, through various media, between and among all generations.

The best thing that we could do now to promote long-range intergenerational equity and amity would be to reduce significantly the non-Social Security deficit (and thus, at the same time, the National Debt).

(continued)

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Question 3. "If the balancing of the non-Social Security budget is so important for our Nation's economic future, and non-Social Security taxes and Social Security payroll taxes are intermingled, why don't we forget about separate trust funds and focus on putting our budget in order?"

I do not believe that the Social Security taxes and other taxes are really "intermingled." The crucial factor is that the Social Security taxes are used to purchase government bonds (which could be done in the open market, and then there would be no question about "intermingling"), whereas the other taxes go directly and entirely into the General Fund.

I believe that the existence of the trust funds is essential, so as to provide proper fiscal discipline and to assure public confidence in the viability of the Social Security program. I must emphasize that the government bonds held by the trust funds are valid; they are not "worthless IOU's, because the money has been spent" (which erroneous criticism could be levied against any other type of investment that people make with institutions!).

Finally, I believe that the non-Social Security budget should be more nearly balanced, and it should not have the more-than-$200 billion annual deficits now present (and growing over the future). If we, the current working population and aged population do this, we will be removing an inequitable burden which will otherwise be placed on the generations who will come to the working ages some decades in the future. And in this way, inter-generational equity can be advanced.

Chairman ROYBAL. Thank you, Mr. Myers.
Mr. Ball.

## STATEMENT OF ROBERT M. BALL

Mr. BALL. Mr. Chairman, I have a rather long statement. I would like to have it in the record, and then I will briefly summarize.

Chairman ROYBAL. All right. The statement will be included in the record, and we would welcome your summary.

Mr. BALL. Mr. Chairman, I might remind the committee of some of the connections I have had with Social Security and the issues before the committee. I was commissioner of Social Security from 1962 to 1973. Then I was a member of the National Commission on Social Security Reform, the Greenspan Commission, that resulted in the 1983 amendments, and I am currently a member of the statutory Advisory Council on Social Security, appointed by Secretary Sullivan, that is reexamining all of these issues. So I have a very deep interest in all the matters that have come up here today.

I think you are going to find that Mr. Myers and I agree on almost all the facts and the history, but have a rather different view of what should be done.

First, I would like to quickly state my position so that we can get to questions. I won't spend much time supporting my views in this summary. I would be glad to do so under questioning if you wish. I think either pay-as-you-go or partial reserve financing will work for Social Security. You could do it either way. In practice, we have been on pay-as-you-go in the past; the 1977 amendments shifted over to partial reserve financing. Both approaches work.

There are, however, some disadvantages if you go to pay-as-you-go financing you give up the potential of having the Social Security buildup contribute to an increase in the Government savings rate and, therefore, to the national savings rate, and you give up, therefore, the possibility of having the Social Security surpluses increase the pool of goods and services out of which retirees of the future will have to be supported.

You also by going to pay-as-you-go raise a real question down the road about whether you can maintain the promised level of benefits. The very steep increases in contribution rates that are required under a pay-as-you-go system will rather sharply raise the question of, "Well, maybe you ought to cut benefits instead."

Under the Moynihan bill, for example, from the beginning of 2012 to the beginning of 2025, just a 13-year period the contribution rates rise by 50 percent. The people who would be getting the benefits at that time are people who have been paying for the last 20 years at only a 5.1 percent rate. Then you would be asking other people to pay in at this much higher rate. That gives me concern from a political and tactical standpoint.

Also, in my view, if you were to go to pay-as-you-go, you ought not to do so until the OASDI system is at 150 percent of the next year's outgo. I don't disagree with Bob that 100 percent would probably be enough. I just feel, in light of the problems of the mid 1970s and early 1980s, that we want to lean way over backwards and have a fat cushion before we would consider reducing OASDI income, even under pay-as-you-go.

I'm not for going to pay-as-you-go but, if that were the decision, we ought first to have a very sizable contingency reserve actually in place. And then even if we did that, I would not reduce the overall Social Security contribution rate. I think the Medicare system. the hospital insurance part, will be close enough to the line in the next several years so that the safe procedure even if you wanted to go pay-as-you-go for OASDI would be to shift part of the contribution rate from the OASDI system to the Medicare system.

Now, I also believe partial reserve financing should meet certain conditions. I would not favor reserve financing if we were to continue as we are and have the borrowed funds spent for the operating expenses of Government.

It seems to me the condition for partial reserve financing should be that the annual excess funds be true savings and contribute to a larger pool of goods and services later on. We can accomplish this only if the Congress and the executive branch have the discipline to finance the operating expenses of the Government largely out of funds other than the Social Security funds. If that condition is met, then it seems to me there are considerable advantages in continuing in the direction of partial reserve financing.

Mr. Chairman, I think I've laid out my views sufficiently for a beginning. There are other points to be made, and my full statement tries to address each question in the letter that asked me to testify. Bob and I have a little different interpretation of what happened on the National Commission of Social Security Reform, of which he was a staff director and of which I was a member. It is not too different but perhaps it is worth stating my views.

I think that the commission very clearly decided against pay-as-you-go. The commission clearly did not want to reduce the 1990 rate of 6.2 percent of earnings already in the law as a result of the 1977 amendment, as you would have to do under pay-as-you-go. Moreover the majority, the 10 members appointed by Republicans who were on the commission, clearly did not want to raise the rate above 6.2 percent in later years as you would have to do under pay-as-you-go.

I agree with Bob that there was no theoretical discussion of partial reserve financing versus pay-as-you-go, but I do think there was a rejection of the pay-as-you-go approach for at least that time.

[The prepared statement of Mr. Ball and answers to written questions submitted by Chairmen Roybal and Hughes and Representative Marilyn Lloyd follow:]

**TESTIMONY OF ROBERT M. BALL**

SELECT COMMITTEE ON AGING

SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT

FEBRUARY 28, 1990

VARIOUS QUESTIONS CONCERNING CHANGES IN SOCIAL SECURITY FINANCING

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

My name is Robert Ball. I was Commissioner of Social Security from 1962 to 1973. Prior to my appointment by President Kennedy, I was a civil servant at the Social Security Administration for some twenty years. Since leaving the government I have continued to write and speak about Social Security and related programs. I was a member of the 1978-79 Advisory Council on Social Security and more recently was a member of the National Commission on Social Security Reform, the Greenspan Commission, whose recommendations were included in the 1983 amendments. I am currently a member of the Quadrennial Advisory Council on Social Security established by statute and appointed by Secretary Sullivan.

**DEFINITIONS AND INTRODUCTION**

It may be of some use to the Committee as reserve financing and pay-as-you-go are discussed over the period ahead to have in mind some definitions of terms. I believe the following definitions would, in general, be agreed to by those working in the field of Social Security.

Pay-as-you-go (or current cost financing) is a financing method providing annual income to the system close to the annual payout but with a contingency reserve sufficient to carry the system through unexpected periods of poor economic performance. Opinions differ, but for pay-as-you-go most experts favor a contingency

reserve at the beginning of the year which is equal to 100% to 150% of the next year's outgo. Since benefits and administrative costs under the system are expected to grow, ordinarily annual income to the fund should exceed outgo to the extent necessary to keep the reserves at the chosen ratio.

**Full Reserve Financing** is a necessary requirement for full safety under private insurance. Since private plans are voluntary it would not be proper to count future income against current liabilities. A full reserve meets the test of liquidation--that is, to be sound the reserve must be sufficient to cover all accrued liabilities without counting on future income. It has never been contemplated that the American social insurance system needed to, or should, meet such a test. The continuation of the government is assumed in the financing plan, and since the coverage is compulsory, the system has been considered in balance if reserves plus estimated future income approximates future estimated obligations.

**Partial Reserve Financing** is any reserve which goes beyond the requirements of safety as defined for contingency purposes under pay-as-you-go and is short of a full reserve. It is a reserve designed to earn interest income and reduce the size of future contribution rates.

What is the current plan? The plan in present law would gradually move the system to a partial reserve basis.

However the funds have not yet reached a level that most experts would consider adequate for a contingency reserve under pay-as-you-go. The reserve is currently 75% of the next year's estimated outgo.

Sometime in the next few years, depending on economic performance and one's definition of adequacy, the trust funds will reach a sufficient contingency level, and under present law the annual surpluses will then begin to build a partial earnings reserve. If one is satisfied with a contingency level for a pay-as-you-go system equal to only a year's outgo that level might well be reached next year if the economy performs well. But the 150% level, which I believe is needed for pay-as-you-go, will not be reached until sometime between 1993 and 1996, the exact date depending on economic performance. Once an adequate contingency reserve is reached, under present law Social Security would move toward partial reserve financing.

The interest on the growing reserves when combined with the present contribution rate of 6.2% of earnings, and the income from the taxation of Social Security benefits of higher income people is estimated to be sufficient to pay all benefits and administrative costs for the next 55 to 60 years. Under present projections, the trust funds would then be exhausted. If we wait until the reserves are used up, it would then be necessary to raise the rates to the pay-as-you-go level, which at that time is estimated to be 8.1%. If we were to raise the rates sooner, the increase could be smaller since the reserves would continue to earn interest.

Mr. Chairman, in Mr. Tauke's and your letter asking me to testify you raised several specific questions. Let me turn to them.

**What Should Be the Role of the Social Security Trust Funds?**

The major support for the payment of Social Security benefits comes from the deductions from workers' earnings matched by employers' contributions and to a much lesser extent taxes on the Social Security benefits of higher-income beneficiaries. Interest earnings on investments held by the trust funds are also a factor, but they have not been very important in the past because, in practice, the system has been largely on a pay-as-you-go basis. Interest earnings, and therefore the trust funds, would become significant under present law as a partial earnings reserve is built up.

If we returned to pay-as-you-go, although the contingency fund earns interest, the amount is not large enough to figure significantly in the financing plan. Under pay-as-you-go financing, the main purpose of the trust funds is to see the system through periods of unexpected economic difficulty without the need to change contribution rates or to borrow. Under reserve financing, the investments of the trust funds can contribute importantly to financing future benefits by holding down future contribution rates, in addition to providing the safety margin required under pay-as-you-go financing.

Which of the two roles for the trust funds is selected is more a matter of economics than of Social Security policy. Social Security will work under either approach, but under partial reserve financing, the build-up in the reserves can contribute to national saving if combined with the prudent management of other government finances. This is a desirable overall economic objective but is not crucial to the success of the Social Security system. What is crucial to Social Security is that certain conditions be met if we are to follow a pay-as-you-go approach and certain other conditions must be met if we are to follow partial reserve financing.

Conditions for a pay-as-you-go system--If a decision were made that the OASDI system should be kept on a pay-as-you-go basis, it is of great importance that the reserve should be at a fully safe level before present OASDI contribution rates are reduced. Despite all the talk about huge reserves accumulating in the trust funds, the buildup lies mostly in the future. Given the wrenching experience the country went through with two Social Security financial crises--one in the mid-1970's and one in the early 1980's--before reducing income to OASDI we ought to lean over backwards to provide a contingency reserve with a substantial cushion. I would favor a reserve equal to 150% of the next year's outgo. As stated before, this level will not be reached until sometime between 1993 and 1996, depending on economic performance.

In my view, it is not advisable to reduce rates now on the basis of estimates that some time in the future we will reach the desired 150% ratio. The sooner we get to a fully safe level, the better. Furthermore, however reasonable the estimates appear at the time they are made, they may, and sometimes do, later turn out to be quite wide of the mark.

**Conditions for Partial Reserve Financing**--Partial reserve financing seems to me to make sense only if the fund build-up is handled in such a way as to increase the national saving rate and through investment produces a larger pool of good and services in the future. Since the retirees of the future have to be supported out of the goods and services produced in the future, the only present actions that make it easier to meet their needs are those that improve our capacity to produce.* If a buildup of reserves results in a greater surplus in the total accounts of the government (or a lower deficit), then the Social Security reserves increase national saving and the capacity to produce goods and services. Or,

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* A trade surplus and investing abroad, however, could remove some of the burden of supporting future retirees, at least for a time. The United States is now pursuing an opposite course, with a large trade deficit and a large amount of debt held by foreigners, both factors which could make it more difficult to meet our future needs.

if somehow the buildup in the reserves were used to provide directly for government investment beyond the level that would occur anyway, then that too would increase future production.

On the other hand, if Treasury borrowing from the reserve merely substitutes for general taxes as a way of paying for the current operating expenses of government, the Social Security buildup does not contribute to economic growth and paying future Social Security claims will be as much of a burden under reserve financing as under pay-as-you-go. They will not be any more of a burden, but the reserve will not have made it any easier.

A Social Security buildup that increases our capacity to produce is possible but not easy to accomplish. We have to exercise enough restraint to finance programs other than Social Security (with the exception of increases in government investment) without relying on borrowing from the trust funds. If, as the Social Security funds lend money to the Treasury (receiving in return bonds and interest earnings) the money is used for current operating expenses, the result is that we have recognized the obligation of the government to pay Social Security benefits in the future, but we have not increased its ability to do so any more than under a pay-as-you-go system. Instead we have substituted borrowing from Social Security for general taxes as a way of meeting the current operating costs of government. This result would be undesirable, not because Social Security funds are being misused or because Social Security

investments are only IOU's, as is sometimes said--all bonds are IOU's--but because viewed solely as a tax, Social Security contributions are somewhat regressive, and moreover we would not be using the fund buildup, as we could, to increase the future pool of goods and services.

Deductions from workers' earnings (with matching contributions by employers) which rise proportionately as earnings rise and with a cap at the point earnings are no longer counted toward benefits seem to me the ideal way to finance a social insurance program. And it is the way we finance OASDI. The contributory nature of the program helps establish an earned right to the benefit and at the same time imposes a discipline on the system; higher benefits require increased contributions.

In the United States this contributory system viewed as a whole is progressive. Because of the weighted benefit formula, lower-paid workers get more protection in relation to their contributions than higher-paid workers do. Moreover the earned income tax credit relieves the lowest-paid wage earners with children from, in effect, making any Social Security contributions; they get a refund approximately equal to the combined employer/employee Social Security tax. You cannot correctly call a system like that regressive.

On the other hand, separated from the benefits, the Social Security tax alone would be mildly regressive. For most workers the tax is proportional to earnings, but the 7% or so of earners who are above the Social Security maximum pay the same as those at the maximum, and income from capital is not subject to the Social Security tax. This is appropriate for a social insurance program but it would not be a good way to finance the general operating expenses of government.

Therefore, Mr. Chairman, I would argue that partial reserve financing is desirable only if we have the political will to bring the non-Social Security budget into relatively close balance, although perhaps allowing for at least part of government investment to be financed through borrowing from Social Security funds. The buildup in the Social Security funds should not be borrowed to pay for the current consumption of government but should be used only for government investment and to buy back the national debt now held in private hands. Under only these circumstances does the Social Security fund build-up add to economic growth. If the fund buildup is not handled in this way, it would be better once we reached an adequate contingency level for a pay-as-you-go system to stop the buildup and continue on pay-as-you-go.

The role of the Social Security trust funds is thus a different one depending on whether we follow a pay-as-you-go plan or a partial reserve plan. In either case there are conditions that should be met before either approach is acceptable.

**Do you agree that the trust fund reserves are being used to mask the size of the government's overall operating defict? Should we be concerned by this accounting practice?**

The first of these questions becomes important if we move to partial reserve financing so that the annual surpluses in Social Security continue to be sizeable. Under pay-as-you-go financing, since the annual surpluses are only sufficient to maintain the same continuing ratio between the fund and the next year's outgo the issue is not an important one; the annual surpluses largely disappear.

I would, however, like to see Social Security removed completely from the unified budget for a different reason. Including Social Security in the Gramm/Rudman targets each year raises the question of whether or not Social Security benefits ought not to be cut to help the overall budget balance, and I don't believe that is desirable. Social Security is a long-term program. People today are paying for benefits that they may not collect for up to half a century. To start changing Social Security because of problems in the general budget is a mistake and destructive of people's confidence in the program. So I am concerned about the Gramm/Rudman targets including Social Security for this reason. But under pay-as-you-go financing there would soon not be enough of an annual surplus to present a problem in terms of masking the size of the government's overall operating deficit. Any Social Security

funds not needed to pay current benefits are invested in government securities and the government uses the money for whatever general purposes it wishes and pays interest to the Social Security trust funds. There is nothing inherently wrong with this procedure.

The problem of masking arises under partial reserve financing where the annual surpluses are very large and where they can serve as an important substitute for other ways of financing the current consumption of government. In this case we have much more than an accounting problem; we have a substantive problem of, in effect, supporting the current activities of government from a somewhat regressive tax instead of from taxes better designed to cover general operating expenses. And unless the large Social Security buildup is saved, reserve financing doesn't make it easier to support Social Security benefits. So far, since the 1983 amendments we have just been getting back to an adequate contingency level for a pay-as-you-go system, and I see no problem in the way the funds have been handled. They are being invested in government securities just as they have in the past, and the trust funds are receiving a reasonable interest rate on what the Treasury has borrowed. It is only as we move into reserve financing that I would have concern with "masking the overall operating deficit" if because of Social Security annual surpluses we failed to bring the operating deficit into approximate balance.

**Was it the intention of the 1983 National Commission on Social Security Reform to shift from pay-as-you-go financing to the building of a large trust fund surplus designed to help finance the retirement of the "baby-boomers?"**

The design of the system after 1990 was not pay-as-you-go at the time the Commission met. The recommendations of the Commission retained the fund buildup in the 1977 Act and increased that buildup further by benefit cuts and moving most of the scheduled 1990 rate of 6.2% to 1988. The pay-as-you-go approach which would have required a reduction in the scheduled 1990 rate and a later rapid increase in rates beginning about 2010 as the baby-boom generation retired was not even considered. It is my belief that a proposal for the kind of rapid increase in the rate that would have been required in the 13 years from 2012 to 2025 would have been countered by proposals to reduce benefits instead, and this is probably still the case. It was well known prior to 1983 by students of the program that reserves would build in the Social Security system beginning in the early 1990's and continuing into the next century. The relatively low fertility rate during the years of the big depression of the 1930's results in the increase in the number of elderly slowing down in this period, and since the baby-boom generation continues in the labor force, the ratio of workers to retirees remains relatively stable. Thus increases in productivity are translated into Social Security surpluses.

On the other hand, there was not a real discussion of the merits or demerits of a further fund buildup. The problem addressed by the 1983 National Commission on Social Security Reform was first and foremost to get from 1983 to 1990 and to prevent financing problems from arising again in the 1990's and the early part of the next century. This was accomplished by a series of changes in the benefit and taxing provisions of the law.

There was also a longer range financing problem which the Commission wanted to solve. The 1977 amendments had aimed at balancing the system over a 50 year period instead of the usual 75 year period and a deficit 50 to 75 years in the future remained at the time the Commission met. As a by-product of the changes designed to solve the short- and middle-range problems about two-thirds of the long-range deficit in the program's financing was also eliminated. The Commission then split on how to deal with the remaining part of the truly long-range deficit. Those members of the Commission appointed by Republicans, the President and the Majority Leader of the Senate, recommmended an increase in the age of first eligibility for full benefits, in other words, a benefit cut, and it was this recommendation that was adopted in the 1983 amendments. Those on the Commission appointed by the Democrats, the Speaker of the House and the Minority Leader of the Senate, suggested instead a contribution rate increase around 2020 in the event that it turned out that such an increase was actually needed.

Under the agreed-upon recommendations and either of the long-range solutions, there would have been a considerable buildup in the trust funds beyond those inherent in the 1977 Act, but the additional buildup was largely incidental to producing a balance between income and outgo over the 75 years for which the estimates are made, rather than a deliberate decision to move further toward reserve financing.

It should be remembered that the ultimate tax rate for OASDI in present law, 6.2% in 1990, is the same rate that was provided for 1990 by the 1977 amendments, and it is this rate that is producing the buildup in reserves. Given the Commission's charge of restoring financial health to the system there was no disposition on the part of the Commission to reduce any financing already in the law.

On balance, I believe it is fair to say that the specific issue of assessing pay-as-you-go financing versus building a large trust fund surplus to finance the retirement of the "baby-boomers" was not examined. However, no one wanted to reduce the 6.2% ultimate rate and the 10 members appointed by Republicans did not favor going above that rate as you would have to under a pay-as-you-go system.

The inevitable consequence of the positions taken by the Commission was to build a large reserve for the first part of the 75 years over which the estimates are made and then to dissipate it over the second part of the estimating period. This pattern of a

big fund buildup and its later dissipation might be sensible if the cost of financing the retirement of the baby-boom generation were a one-time cost--a rabbit through the Python phenomenon--with lower costs expected later, but such is not the case. The retirement cost of the baby-boom generation establishes a new plateau of cost that is more or less flat thereafter. This is so on the assumption that fertility rates will continue at their present low levels and that mortality rates will continue to improve so that the ratio of those of working age to those of retirement age remains relatively constant. Given these assumptions, a more sensible partial reserve plan than present law might be to keep the current 6.2% rate to 2020 or 2030 and then put in a rate increase to avoid having to cash in the bonds. If the 6.2% rate were raised to 7.1% in 2020, it would be sufficient to carry the system past 2065, the end of the 75 years over which the estimates are usually made and end the period with a reasonable contingency reserve. It is estimated that with a 7.1% rate no bonds would have to be cashed in for the next 70 years.

**Should Social Security be returned to more of a pay-as-you-go system at this point? Once we have reached what might be considered a "safer" trust fund contingency reserve is a pay-as-you-go system inherently any more threatening to the future benefits of retirees in the year 2015 and beyond than building up a large reserve?**

I would certainly not put Social Security on a pay-as-you-go system at this point. As I have stated earlier, I would want first

for the reserve to have reached 150% of the next year's outgo, which will not occur until sometime between 1993 and 1996. Furthermore, I have some preference for partial reserve financing providing the rest of the government's finances are handled in such a way that the annual surpluses in the OADSI system contribute to national savings. I do not feel as strongly on this point as do many others, but I think it is desirable.

Pay-as-you-go has some disadvantages. The most fundamental disadvantage is that the Nation would forego the increase in the future pool of goods and services that reserve accumulation combined with the prudent management of other government finances makes possible. How important this is and how much difference such savings would make in future production is more of an economic question than a Social Security question. The benefits of increased wage growth go well beyond the Social Security system, but there is a Social Security interest. Future Social Security benefit levels may be somewhat better protected to the extent future wage earners have more income because the easier it is to pay for Social Security benefits, the more likely it is that benefit levels will be maintained. Moreover, if contributors in the future recognize that retirees, together with their employers, have pretty much paid their own way, there will be less disposition to cut benefits.

Another disadvantage of pay-as-you-go is that in return for lower rates now you have to have higher rates later. If instead of

everyone from now on paying a contribution rate of at least 6.2% of earnings, the rate drops, as in the Moynihan bill, to 5.1% from 1991 through 2011 and then rises to 7.7% in just 13 years, there will certainly be pressure from those faced with a 50% rate increase to resist the increase and instead cut benefits for those who paid a much lower rate in the past. To this extent, I think a pay-as-you-go system is more threatening to the future benefits of retirees than building up a large reserve.

**If the Moynihan proposal were to pass, do you believe Social Security benefits would be jeopardized in the short- or long-term? What effect would this proposal likely have on Social Security tax rates between 2015 and 2045? How would these rates compare to those projected under the current system?**

As I have said, I believe that partial reserve financing does provide somewhat greater security for Social Security benefit levels. I do see a possibility of conflicting pressures from contributors and beneficiaries under pay-as-you-go when the baby-boom starts to retire and rates under pay-as-you-go would have to rise rapidly.

I am equally concerned about Medicare. Even if OASDI is put on a pay-as-you-go basis, I believe the overall Social Security contribution rate should be maintained. The 1.45% of covered earnings allocated to the hospital insurance program under Medicare

out of the overall Social Security contribution rate of 7.65% is clearly inadequate. If the economy performs less well than it has in the recent past, payments from hospital insurance could start to exceed income as early as 1995, with all the bonds held in the hospital insurance fund liquidated by the end of the decade.

If we decide to adopt pay-as-you-go for OASDI, the safest way to do it is to transfer part of the OASDI rate over to Medicare, just as in the past the tax rate has been reallocated between old-age and survivors insurance and disability insurance. Otherwise we will cut the combined rate now with great fanfare and just have to raise it again very soon for Medicare--unless, of course, it is decided to cut benefits instead. That is always a possibility if the programs get close to the financial cliff, as old-age and survivors insurance did in 1982. That financing crisis was resolved by benefit cuts in the 1983 amendments along with a speed-up in the contribution rates. The best protection for benefit levels in both OASDI and Medicare is adequate financing. A good pay-as-you-go plan, therefore, would be to wait until about 1995, when an adequate contingency reserve is ensured and then transfer part of the OASDI rate to Medicare.

The pay-as-you-go rates in Senator Moynihan's bill, S.2016, are reasonable for his pay-as-you-go plan. In 2015 the rate would go back to the present rate of 6.2% for five years (2015-2019), to 7% for the next five years (2020-2024), to 7.7% (from 2025-2044),

and finally to 8.1% (2045 and later). Under the present system, the current rate of 6.2% could be continued to approximately mid-century and then since the trust funds would be exhausted, the system would be on a pay-as-you-go basis with a rate of 8.1% as in the Moynihan bill.

As I stated earlier, I do not believe that the present large buildup in reserves and their subsequent dissipation as in present law is the best approach to partial reserve financing. If we are to stay on partial reserve financing I would propose instead that in 2020 the rate be raised from 6.2% to 7.1% which would almost entirely avoid having to cash in trust fund bonds over the 75 year period ending in 2065 and which would end the 75 year estimating period with a reasonable contingency reserve ratio. Alternatively the 6.2% rate could be kept until 2030 and the rate raised to 7.45% with approximately the same result.

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March 29, 1990

Chairman Edward R. Roybal
Select Committee on Aging
U.S. House of Representatives
House Annex #1, Room 712
300 New Jersey Ave. S.E.
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed you will find my responses to the questions asked in your letter of March 9, 1990.

Sincerely,

Robert M. Ball

Enclosure

Responses to Chairman Roybal's letter of March 9, 1990.

1) Does the Social Security Trust Fund have adequate reserves at present to cut Social Security payroll taxes and return to a pay-as-you-go approach to financing, without putting at risk the benefits of future retirees?

Not in my opinion. I believe that if we were to return the system to a pay-as-you-go basis that there ought to be a reserve of at least 150% of the next year's outgo. I believe further that benefits of future retirees will be safer under a partial reserve system than under a pay-as-you-go system for reasons that I have explained in my testimony.

2) If a Social Security payroll tax cut, similar to what was proposed was passed this year, would there be enough contingency reserves in the Social Security Trust Fund to handle a significant down-turn in the economy in the future?

It all depends on the meaning of the phrase, "significant down-turn in the economy." At present, the reserves are about 75% of the next year's outgo and with the level of tax contributions compared to benefit outgo the present reserve ratio would certainly be sufficient to handle an ordinary recession. I believe, however, in the light of the great importance of safety in the Social Security system that we should have a contingency reserve under a pay-as-you-go system sufficient to weather serious back-to-back recessions, and that we probably do not have.

3) Would the Social Security payroll tax have to be significantly increased in the future if we cut the payroll tax today, and Social Security were returned to a pay-as-you-go approach?

Yes. The pay-as-you-go rates in Senator Moynihan's bill are the best guess of the Social Security actuaries of the kind of tax increase that would be needed in the future under a pay-as-you-go approach. Thus, if we reduce the 6.2% of earnings currently going for the old-age, survivors and disability insurance program to the pay-as-you-go rate of 5.1%, then in the 13-year period from 2012 to 2025 the rate would have to be increased by about 50%. Under the Moynihan bill, the rates go from 5.1% to 7.7% in this period.

It should be noted, however, that under present law, since the trust funds are exhausted near the middle of the next century, it would also be necessary at that time to go from the present 6.2% rate to a pay-as-you-go rate, which by then would be 8.1% of earnings. In my view, present law is not the best way to handle a partial reserve financing plan. If we are to build a large trust fund, I would maintain it, use the interest earnings to pay benefits and not let the fund become exhausted.



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If we were to leave the rate for OASDI at the 6.2% of earnings level where it now is and increase that rate to 7.1% or 7.2% in the year 2020, the system would be adequately financed over the whole 75 years for which the estimates are made, investments would not have to be cashed in and we would end up the 75-year period in 2065 with a substantial reserve. This is to be compared with the 8.1% of earnings that would be necessary in 2045 and later under pay-as-you-go financing.

4) What is your view of current proposals to "privatize" Social Security, by using the surplus to establish IRA's? Would this change the fundamental progressive nature of Social Security by no longer giving lower-income workers more benefits in proportion to their contributions than higher-income workers?

I am opposed to the idea of "privatizing Social Security" by using Social Security annual surpluses to establish IRA's. One of the main reasons is implied in the second question. All the privatization schemes that I have seen drop the redistribution feature of Social Security and give people benefits related solely to the contributions they have made and the contributions made by their employers on their behalf. It is hard to see how a scheme based on IRA's could do anything else. Yet, one of the most important features of Social Security is to give low-wage earners a greater return for their contributions than is true for high earners. This is the device used to keep millions of low-paid earners from having to turn to a means-tested program in old age or disability and to keep their families from having to do the same in the event of the wage earner's death. (It should be noted, however, that Congressman John Porter of Illinois has stated that he intends his plan to preserve the equivalent of the Social Security weighted benefit formula through some sort of government subsidy. As far as I know, he has not yet spelled out how this would work.)

Another fundamental problem in the privatization schemes is that the first generation of workers will fund their own benefits privately and must also continue to pay for the retirement benefits of older workers who remain under the Social Security system. In effect, the first generation is required to pay twice.

There are other features that seem to me undesirable. I know of no way that private plans can fully protect against the possibility of inflation; the benefit can provide for a constant increase in the amount to be paid such as 2% or 3% a year, but it is difficult to see how a private plan could guarantee to keep a benefit up with inflation regardless of how high the inflation rate is.

I am also concerned about the safety of the investments in privatization plans. Frequently the sponsors of these plans claim unrealistically high rates of return sustained over long periods of

time. First of all, real returns on private investments move up and down--for example, with very low or zero returns in the 1970's and greater returns in the 1980's. The individual's security will, therefore, be greatly affected by the period of investment. Moreover, returns that exceed what can be earned on long-term Treasury investments are by definition riskier. Investment mistakes will be made and people will lose out and other taxpayers will have to make up for loses by supporting the losers through means-tested programs.

It seems to me that the present system is well designed to be a basic program to which people can add private pensions and personal savings. I see no significant advantage in privatizing the basic Social Security system, and I see many disadvantages in doing so.

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March 29, 1990

Chairman William J. Hughes
Select Committee on Aging
Subcommittee on Retirement Income
and Employment
714 House Office Bldg. Annex 1
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed you will find my responses to the questions asked in your letter of March 15, 1990.

Sincerely,

Robert M. Ball

Enclosure

3/26/90

Responses to questions in Chairman Hughes letter of 3/15/90

1. Will gradually returning to a "pay-as-you-go" system, after a sufficient reserve is obtained, cause a major, insupportable payroll tax increase in the next century?

One of the reasons that I'm concerned about returning to a pay-as-you-go system is that it will require very steep increases in the payroll tax as the baby-boom generation starts to retire in the next century. Under the Moynihan bill, there is a 50% increase in contribution rates from 2012 to 2025. The rates go from 5.1% in 2011 to 7.7% at the beginning of 2025. Later on in 2045 the rate goes to 8.1%. I don't believe that this contribution rate is "insupportable," but I think the rapid rise in the rate from 5.1% to 7.7% could cause serious concern and possible strong disagreement between contributors and recipients.

2. Would you support a shift within the payroll tax, from OASI to HI, after a sufficient reserve is built up in the OASI trust fund, to prevent a shortfall in HI?

I prefer to continue a plan of partial reserve financing, but if the decision were to return to pay-as-you-go, then I believe it would be better to shift part of the payroll tax from OASDI to HI rather

than reduce the overall Social Security tax. There will almost certainly be a shortfall in HI financing in the relatively near term, and it seems to me unwise to reduce the Social Security tax and then just have to raise it again.

3. What is your opinion of the Administration's "Social Security Integrity and Debt Reduction Fund"?

It seems to me the Administration's proposal does have the effect over time of protecting the Social Security reserves and contributing to the country's saving rate. On the other hand, I would prefer to take the Social Security system entirely out of deficit reduction targets. As long as Social Security is counted for deficit reduction purposes, there is always the possibility that short-term budget considerations will result in undesirable Social Security changes. I don't think Social Security should be part of year-to-year budget considerations. Social Security is a long-term program. People today are paying for benefits that they may not collect for up to half a century. To start modifying the program because of non-Social Security problems in the general budget is a mistake and destructive of people's confidence in the program.

Questions from Representative Marilyn Lloyd

1. Do you believe that non-Social Security taxes are too low to pay for non-Social Security spending?

Yes. This clearly is the case. Taxes need to be raised by roughly $200 billion a year to cover non-Social Security spending.

2. The Social Security payroll tax system has been characterized as less progressive than the income tax system.

Do you believe that the American public would support a cut in Social Security payroll taxes in exchange for an increase in personal or corporate income taxes?

I don't know the answer to this question about what the American public would support, but in the past they have been more willing to support increases in Social Security taxes than in the income tax because, I believe, they see Social Security taxes as an integral part of the Social Security system. The public strongly supports Social Security. They like the idea of the benefits, of course, but they also like the idea of paying for them by deductions from workers' earnings and matching contributions from employers.

In my judgment, the way Social Security is financed is entirely appropriate for a social insurance system, and when one looks at the entire program, that is, benefits and contributions, it is progressive. This is because lower-paid earners get a greater return in comparison to what they pay in than is true for

higher-paid workers. However, using Social Security taxes for the general operating expenses of government is mildly regressive and would not be a good idea. Looked at solely as a tax, the fact that people above the maximum cut-off point pay the same as those earning at the maximum and the fact that income from capital is not taxed make the payroll tax an undesirable way of supporting the general purposes of government. However, for all but the 7% of workers who have earnings above the Social Security maximum, the Social Security tax is proportional--that is, it rises with earnings--rather than regressive. My belief is that we need to keep Social Security taxes where they are and probably later on increase them somewhat and that at the same time we need an increase in the personal and corporate income taxes. I believe the deficit and the consequent build-up in the debt is such a handicap to what we want to accomplish in this country that I would favor a great variety of taxes designed to reduce the deficit including increases in excise taxes on tobacco, alcohol and gasoline, which I believe would also have certain desirable side-effects.

3. Under the Administration's proposal, the budget is eventually balanced, and it continues to use Social Security receipts in calculating deficits under Gramm/Rudman/Hollings. This means that past and planned increases in the Social Security payroll tax rates allow this balancing to occur.

Do you believe that the Administration should use the Social Security payroll tax to do this over some other type of tax?

As I understand the Administration's proposal, the non-Social Security budget is eventually balanced and an amount equivalent to the build-up in the Social Security reserves is then used to buy back the debt now held in private hands. I believe this is a desirable procedure although I have another kind of disagreement with the Administration's proposal--I believe that Social Security ought to be taken entirely out of the budget calculations. I do believe, however, that it is desirable to use the build-up in the Social Security reserves to buy back the debt now held in private hands. I favor such a build-up because I think it is the prudent way to finance Social Security and because it avoids the sharp increases in Social Security taxes later that would be necessary under a pay-as-you-go plan. Moreover a partial reserve plan for Social Security can contribute to increased production later on if the rest of government finances are handled in a responsible manner.

Chairman ROYBAL. Thank you.
Mr. Burtless.

## STATEMENT OF GARY BURTLESS

Mr. BURTLESS. Thank you very much. I am honored by the invitation that you sent to appear before the committee. My prepared comments are fairly brief, and they will deal with two issues. The first is how the trust funds should be invested, and the second is the recent proposal by Senator Moynihan.

I have given more detailed responses to the questions in your letter of invitation in a formal statement which I hope will be entered in the record.

The Social Security trust funds are now accumulating large reserves. The reserves can reduce the burden on future workers of paying for retirement benefits that must be paid out when the baby boom generation retires. The burden on future workers can only be reduced if the growing surpluses actually boost national saving and investment over the next 2 or 3 decades. For this to occur, the President and the Congress will have to adopt a different budget policy than the one that we have seen for the last 8 years.

Now, first of all, I don't think we need a different investment policy as some commentators claim. The current policy of investing in U.S. Treasury debt is just fine. To the extent that the trust funds buy Treasury debt, less debt needs to be sold to the general public, so the public has more of its own savings available to invest in private debt, equities, State and local bonds, and all other kinds of productive investments.

I don't personally object to investing the trust funds in a balanced portfolio of private securities. That is okay. I'm afraid that Congress and the Social Security trustees will find themselves involved in very tough political controversies when they try to persuade the public that it's all right for the Government to invest in companies that make cigarettes, or alcoholic beverages, or other goods that are objectionable to certain constituencies.

Members of Congress will also find themselves besieged by voters who object to investments in firms that allegedly discriminate against women, or racial minorities or have branches in South Africa, China, Eastern Europe, or even in Japan. To insulate Social Security investment policy from these kinds of political controversy, you might be better advised to leave private investment to private investors. Invest the trust funds in Federal securities or in obligations of federally-sponsored agencies such as Fannie Mae or Sally Mae.

The policy of investing reserves in State and local infrastructure development, as Bob Reischauer has already mentioned, would significantly reduce the return earned on the trust fund while subjecting it to slightly greater risk.

States and municipalities can already borrow at an essentially subsidized rate because of the Federal income tax exemption granted to interest on State and local bonds. Consequently, the yield on State and local bonds is about 1½ to 2 percentage points below the yield on Federal securities. If the trust funds sought to lend money to State and local governments for capital investment, or human

capital investment, they would have to lend at a rate no higher than the rate that States and cities can already obtain.

I think the people who seriously propose this kind of policy forget that the future level of Social Security taxes depends, in part, on the interest it can earn on its reserves. The lower the interest rate that it can earn, the higher the tax rate will have to be, so calling for investing in these kinds of low-return activities is a call for a higher tax rate in Social Security.

On balance, I think it is a bad idea to abandon current trust fund policy anytime soon except, perhaps, abandoning this opposition to investing in the securities of Government-sponsored agencies, investment which is perfectly okay.

Let me devote the remainder of my time to Senator Moynihan's proposal to cut the Social Security tax. He suggested trimming the tax, a move that would save workers and their employers hundreds of billions over the next decade. I think the reason it looks attractive today is because it is attractive for current employers and current workers, but I also think that it will saddle our children with enormous tax burdens in the next century when the baby boom generation retires.

A large fund, as Bob Ball just mentioned, increases public confidence that benefits will actually be paid in the next century. Even more important, if the current surpluses actually add to national savings by bringing the budget into surplus and reducing the national debt, the Nation's productive capacity will be raised. Added national saving will result in higher investment leading, in turn, to higher productivity and wages.

The slice of the economic pie that will go in the next century to paying for retirement benefits has to be larger. That's a demographic fact of life. The pie out of which we cut that slice can also be larger if we invest the reserves today in increasing the capital stock of the United States. This will leave a bigger slice of the pie for consumption by future workers; I worry about those workers because they include my two sons.

These advantages can only be realized if the payroll tax remains unchanged and if the Federal Government makes a smaller claim on the Nation's very pathetically-depleted pool of savings.

Unfortunately, even though the surplus in Social Security is growing, the deficit in the remainder of the Government is even larger and growing about as fast as the trust fund surpluses. Moynihan is right in describing this policy as one of thievery.

I would compare our current budget situation to that of a man who sets aside $50 out of his monthly paycheck in a savings account for his retirement. Finding himself short of cash in the week before he is paid, he always borrows $150 to buy groceries and pay the rent. As a result, his retirement account grows $50 every period, but his loan from the bank grows $150, and he is $100 net further in debt and in worse shape than ever when it comes to paying for his retirement.

Senator Moynihan suggests cutting the payroll tax. This is a bit like urging the man to stop saving for his retirement because his budget practices are deceptive. Moynihan is right that the deception would end, but the savings account would disappear, too. What's worse, the proposal does not in any way reduce the work-

er's need to borrow $150 every month to pay for his rent and groceries. Since his borrowing continues unchecked, his indebtedness grows $150 every pay period instead of just $100, his financial position goes from bad to worse, and his ability to pay for his retirement is diminished even further.

The problem clearly is not the worker's retirement account but his inability to make ends meet in the rest of his budget. Similarly, the Social Security surplus obscures the extent of the deficit in the rest of the Government budget, but it is not the source of those problems. The fundamental problem is our unwillingness to pay for current operating expenses of the Government out of general revenues. A bigger share of spending has, therefore, been paid out of the payroll tax—a regressive tax I agree, but it is also our retirement savings—and a greater share has been paid out of net new borrowing.

Moynihan is right in arguing that this practice ought to stop. He is wrong in proposing a policy that aggravates the underlying disease. To protect future pensions, we should leave the payroll tax unchanged and let the trust funds grow. But at the same time we must reduce the deficit in programs outside of Social Security so that the surpluses can contribute to national saving. To reduce those surpluses with a tax cut today might yield instant gratification for today's taxpayers but at heavy cost to tomorrow's workers.

Thank you.

[The prepared statement of Mr. Burtless and answers to written questions submitted by Chairmen Roybal and Hughes and Representative Marilyn Lloyd follow:]

# SOCIAL SECURITY FINANCING AND THE BUDGET

Testimony for the

U.S. House of Representatives
Select Committe on Aging
Subcommittee on Retirement Income and Employment

February 28, 1990

by

Gary Burtless[1]

## Background

Thank you for the invitation to appear before this Subcommittee. I have been asked to discuss advanced funding of Social Security, its relationship to overall budget policy, and its possible role in long-term economic policy. Since I favor the current policy of advance funding, I will conclude with an analysis of some frequent objections to the recent Social Security surpluses.

The Social Security Trust Funds are now accumulating large reserves. These reserves can lessen the burden on future workers of financing retirement benefits that must be paid out when the huge baby-boom generation retires. But the burden on future generations can only be reduced if the growing social insurance surpluses actually produce a rise in national saving and investment over the next few decades. For this to occur, the Nation will need a different budget policy than the one it has followed over the past eight or nine years. In particular, it will need to reduce the large and growing deficits in non-Social-Security budget accounts.

While Senator Moynihan's recent proposal to eliminate the Trust Fund build-up is helpful in educating the public about the magnitude of the current budget problem, if adopted the proposal would only exacerbate the problem. The build-up should not be reduced or eliminated. Instead, the deficit in other federal programs should be eliminated. This policy can not only improve our economic capacity to pay for future

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1. Senior Fellow, The Brookings Institution, Washington, DC. The views expressed are solely my own and should not be ascribed to the staff or Trustees of the Brookings Institution.

benefits, it can also restore political confidence in Social Security by assuring younger workers that resources will be available in the next century to finance benefit checks.

The economic and political advantages of advance funding can only be achieved if the buildup in Trust Fund reserves leads to a rise in government (and national) saving. This goal could be attained if the Nation moves toward a budget policy in which the federal government aims over the course of a business cycle to run surpluses roughly equivalent to the surpluses in the main social insurance accounts. I am skeptical that the goal would be any easier to achieve if investment policy for the Social Security reserves were modified to permit investments in private securities or state and local bonds, as some commentators have proposed. The crucial reform we need is to change overall budget policy, not Trust Fund investment policy.

## Trust Fund Reserves and Federal Budget Policy

The move to a partially funded system. Social Security and Part A of Medicare are now accumulating large surpluses. The surpluses in Social Security have not occurred by accident. Amendments passed by Congress in 1977 and 1983 fundamentally changed the financing of Social Security. Before 1977, the program was funded on a pay-as-you-go basis. Tax revenues in a given year were approximately equal to benefit outlays. The main purpose of the Trust Funds was to protect the system against economic downturns in which revenues could temporarily fall short of benefit payments.

The 1977 and 1983 Amendments established FICA payroll tax rates that are substantially above those needed to pay for current benefits. Tax rates could probably drop by about two percentage points -- one point on workers and one point on employers -- over the next 20 years and still leave enough tax revenues to pay for promised benefits during that period. If rates were reduced by this amount, however, tax rates would have to rise about six percentage points in the 20 years after 2010 to pay for Social Security benefits owed to baby-boom workers, who will start retiring around 2010. Although a return to pay-as-you-go financing would be a boon to current wage earners, it would be a bust for workers asked to pay the retirement benefits of baby-boom retirees.

Economic advantages of advanced funding. The move to a partially funded Social Security system provides an opportunity to prepare for the large pension and medical care costs that will face the Nation when the baby-boom generation retires. If the Social Security and Medicare surpluses of the next two decades actually add to national savings -- by reducing the overall federal deficit or bringing the budget into surplus -- the Nation's capital stock will be larger, worker productivity will be higher, and the earnings of future workers will be high enough to offset much or all of the additional burdens that are placed on them by a growing population of Social Security and Medicare recipients.

The incomes of future workers can be higher if worker productivity is higher. Productivity can be higher if the level of capital plant and equipment per worker is higher, enabling each worker to produce greater output for each hour worked. And the level of plant and equipment can be higher if over the next several decades the Nation withholds a greater share of output from current consumption and devotes it to investment in plant and equipment. This can occur only if Social Security accumulates the large reserves projected under current law and if the federal government makes a smaller claim on the Nation's limited pool of private savings. The freed-up private savings can then be devoted to productive new investments rather than to financing current government obligations.

New economic realities. The Nation could have enjoyed the same economic advantages if it had partially funded Social Security (and reduced government dissaving) in 1959 or 1969. What are the special advantages of higher saving in 1989? Why have many economists -- including my colleagues at Brookings -- changed their views on the desirability of running surpluses in Social Security and the federal budget more generally?

One reason is that national saving has collapsed in the 1980s. Federal deficits have reached levels that were previously unimaginable for an economy in the midst of a sustained expansion. Even though saving has begun to recover in the past few quarters, private saving in the 1980s fell sharply relative to its level over the previous four decades. From 1951 through 1980, net national saving in the United States averaged 8 percent of net national product. (Private saving averaged a little more than 9 percent of national income, and federal government dissaving averaged a bit more than 1 percent.) In recent years, the private saving rate has slumped nearly three percentage points, and the federal deficit has jumped three points. Net national saving has fallen by more than half.

The slump in national saving (and the sharp rise in federal government dissaving) explains why many economists think deficits should be reduced to restore the saving rate to a level closer to the historical norm. Henry Aaron, Barry Bosworth, and I have gone further than this and argued for a government deficit that is lower than the historical norm by approximately the amount of the Social Security and Medicare surpluses.[2] We have further argued that those surpluses should be preserved and even boosted above the levels scheduled under current law. In some years this may mean that the government budget -- including Social Security and Medicare surpluses -- is in substantial surplus.

Our views on this issue have been affected by the dramatic declines in productivity growth and population growth that have occurred over the past two decades. If average productivity and the size of the working-age population are

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2. Henry J. Aaron, Barry P. Bosworth, and Gary Burtless, Can America Afford to Grow Old? Paying for Social Security (Washington, D.C.: The Brookings Institution, 1989).

growing, it is less burdensome for workers to finance the retirement benefits of a given generation of retirees. Pensions and medical care for the aged will be paid out of rapidly rising real earnings, and thus the share of earnings that must be set aside for those benefits can be kept relatively low. When productivity growth and population growth decline, a rising share of earnings must be set aside to finance the consumption of the elderly.

Advanced funding and the federal deficit. At the moment, the accumulations in the Social Security and Medicare Trust Funds represent only an accounting fiction. Even though payroll tax revenues are not used up to finance current pension and medical insurance benefits, the money left over is lent to the Treasury where it is used to pay for other obligations of the federal government -- new weapons, biomedical research, civil service pay, and so on. For all intents and purposes, the Nation is using a regressive payroll tax to finance a growing share of operations that formerly were paid for using personal and corporate income taxes. The tax structure of the Nation has become more regressive. And taken as a whole, it now finances a smaller proportion of federal spending than was the case over most of the post-war era. The remainder of spending is financed by borrowing from the American public and from foreigners.

The economic danger of this level of federal borrowing is well known to any reader of a daily newspaper. The main problem is that large federal deficits deplete the already limited amount of private American savings available for investment in plant and capital equipment, housing, and essential infrastructure.

It is ironical that the trend toward higher deficits has occurred in the 1980s, shortly after the President and Congress first recognized the wisdom of building up large Trust Fund reserves in the Social Security system. At a time when the Nation ought to be raising its capacity to produce high incomes to reduce the burdens of a predictable boom in retirements, it is instead reducing the share of national income devoted to saving.

Sen. Moynihan's proposal. Senator Daniel Patrick Moynihan bluntly--and rightly--describes current budget policy as "thievery." Workers pay FICA taxes under the assumption that the money will be used to pay for their own and their parents' Social Security benefit checks. If the current surpluses in the program were actually salted away in productive investments and reductions in outstanding federal debt, the assumption would be correct. Instead the surpluses just mask the size of the deficit in other government programs.

While Sen. Moynihan is right in his diagnosis of the disease, he is mistaken in his prescription for a cure. The disease has two main symptoms. First, reliance on the payroll tax to pay for general government spending has made the overall tax system less fair. Second, federal spending far exceeds taxes, diverting a sizable share of our limited private savings into financing the deficit. Moynihan's prescription alleviates the first symptom--by reducing the burden of payroll taxes. But it makes

the second symptom even worse--by adding billions to an already bloated federal deficit.

A simple prescription would relieve both symptoms: Reduce the size of the non-Social-Security deficit, either through spending cuts or general tax increases. In that way, we would stop paying for B-2 bombers with payroll taxes and give a needed boost to national saving. If Congress and the President lack the will to reduce the overall deficit, Moynihan should continue his fight to make the tax system fairer, possibly by returning the Social Security system to pay-as-you-go financing. But any reduction in the payroll tax must be offset by an equivalent increase in revenues from a fairer source, such as the progressive income tax. Otherwise, we will pass on to our children not only the pension bill for our own retirement but also a federal debt that is trillions of dollars larger.

Changes in law to protect the Social Security reserves. Some policy-makers have proposed changing the Gramm-Rudman-Hollings deficit reduction targets in order to achieve the fiscal policy I favor. In particular, it has been suggested that the targets should be specified in terms of the federal budget excluding Social Security and/or Medicare. On the whole, I support this proposal, even though the budgetary targets would be much more ambitious than those included under current law.

I do not favor an acceleration in the present Gramm-Rudman-Hollings targets. Budget balance under the present definition is supposed to occur in 1993. In that year the surpluses in OASDI and HI are projected by the Congressional Budget Office to be over $110 billion. A sensible amendment to the Gramm-Rudman-Hollings targets would be to require budget balance excluding OASDI and HI by fiscal year 1996. Thereafter, the federal government would seek to maintain budget balance in the non-OASDHI accounts, yielding a surplus in the overall accounts equal to the combined surplus in OASDI and HI. I do not seriously believe that this target would be achieved in every year -- or even in most years. But if the Congress and President achieved the goal of an average one percent non-OASDI deficit over the course of typical business cycles, the burden of retirement benefits on future generations could be lightened.

Another policy that would achieve the same objective is the Administration's proposal to establish a "Social Security Integrity and Debt Reduction Fund." Under this proposal, a specified percentage of annual additions to the Social Security reserve would be counted as ordinary expenditures of the federal government. As such, they would be counted as part of spending in the Gramm-Rudman-Hollings deficit reduction targets. Eventually, all of the additions to Social Security reserves would be counted as spending. If the G-R-H legislation is amended to require budget balance under this definition, say, in 1996, the Social Security surpluses would essentially be used to retire outstanding federal debt now in the hands of the general public. Although this policy sounds unnecessarily complicated, it actually achieves the same overall fiscal policy as removing Social Security from the Gramm-Rudman-Hollings-defined budget and requiring the budget exclusive of Social Security to be balanced.

Trust Fund investment policy. One modification in current policy I oppose is a recent proposal to abandon present Trust Fund investment policy. Under current law, all reserves held in the Trust Funds are invested in Treasury or Treasury-backed securities. Several kinds of modifications of this policy have been proposed. Under one proposal, the Trustees would be permitted to invest in private securities, such as marketable corporate stocks and bonds. Under another, part of the Trust Fund would be invested in state and local bonds or infrastructure development. The first proposal is unnecessary; the second, unsound.

Both proposals are motivated by the belief that Trust Fund reserves invested in Treasury debt do not really add to the Nation's capital stock. Reserves invested in tangible assets, like corporate plant and equipment or government roads and buildings, appear to raise the capital stock. The appearance is illusory, however. The current policy of investing reserves in Treasury securities has essentially the same effect on national saving and investment as the alternative policies proposed. The reason is straightforward. To the extent that the Trust Funds purchase Treasury debt, they reduce the amount of the deficit that must be sold to the general public. Private savers are left with more of their own savings to invest in private or state and local securities. Hence, the amount of money that can be invested in these assets is no different whether Trust Fund reserves are invested in Treasury securities or directly in corporate or state and municipal securities.

For that reason, a policy of investing the Trust Funds in private marketable securities will not raise private investment in comparison to current policy -- although it could get the Trustees entangled in a fierce political debate about the kinds of private investments that are morally acceptable. Assuming that these difficult issues could be resolved, the private investment strategy has one advantage over current policy: it can raise the rate of return earned on the Trust Fund reserves. (The long-term rate of return on the reserves might be raised by one to three percentage points if they were invested in corporate securities rather than government bonds, since corporate securities offer a higher market yield, albeit with higher risk.)

The policy of investing in corporate debt and equities might be highly controversial. To avoid this controversy while still earning a higher rate of return on Trust Fund reserves, I favor liberalizing current investment policy to permit the Funds to invest in federal government-guaranteed securities and the securities of government-sponsored agencies, such as the Federal National Mortgage Association and the Student Loan Marketing Association. Securities issued by these agencies pay a somewhat higher return than U.S. Treasury issues of similar maturity, but they bear very little extra risk.

By contrast, the policy of investing reserves in state and local infrastructure development would significantly reduce the return earned on the Trust Fund while subjecting it to slightly greater risk. States and municipalities can already borrow funds at a rate that is heavily subsidized by virtue of the federal income tax exemption granted to interest on state and local debt. Consequently, the yield on

state and local bonds is about 1-1/2 to 2 percentage points below the yield on federal securities. If the Trust Funds sought to lend money to states and cities for capital investment, they would have to lend at a rate no higher than the rate states and cities can already obtain. People who seriously propose this kind of investment strategy should remember that current financing of Social Security depends, in part, on the interest earnings obtained on the Funds. If interest earnings are consistently below the level that the Trustees now predict, Congress will be forced to raise payroll taxes or reduce promised benefits if the Social Security program is to remain solvent. A lower return will inevitably mean higher payroll taxes or lower benefits.

On balance, it would be a bad idea to abandon the present Trust Fund investment policy anytime soon, except possibly to permit the Managing Trustee to invest in the securities of government-sponsored agencies. The current policy is uncontroversial -- Congress and the Trustees have never been drawn into divisive battles over investing the Funds in one particular security or another. The policy earns a safe and tolerable rate of return. And it has approximately the same impact on national saving and investment as alternative policies that have sometimes been proposed.

The critical policy question with respect to the Trust Funds is whether the current surpluses will add to national saving. This question cannot be resolved by deciding to invest the Funds in one kind of asset rather than another. Whether the surpluses are invested in government debt or private securities will matter little if they do not cause national saving to rise.

Policy choices before us. In the conclusion of our book, Henry Aaron, Barry Bosworth, and I suggest that the Nation faces three choices regarding financing and budget policies for Social Security and Medicare:

1. We can leave the advance funding financing mechanism unchanged but continue to spend the surpluses in Social Security and Medicare for other government operations, essentially using regressive payroll taxes to pay for ordinary government obligations.

2. We can leave the financing unchanged but save the surpluses, by reducing the non-Social-Security, non-Medicare operating deficit to a level approaching its historical norm (about one percent of GNP).

3. Or we can eliminate the surpluses by restoring Social Security and Medicare to the pay-as-you-go financing method that prevailed over most of the post-war era. This would involve a cut in OASDI payroll taxes over the next twenty-five or thirty years.

The first policy alternative is the one that the Nation has apparently adopted, and it is the least desirable. We favor a gradual move toward the second fiscal policy, even though it involves short-term sacrifices. In our view, it is the policy most likely to reduce the burden on future workers of paying for benefits targeted on the elderly. It

is also the fairest policy from the point of view of future generations, and the one that is most likely to inspire confidence in today's workers that promised benefits will actually be paid in the next century. If the second policy appears politically impossible, I favor a return to the third policy. It yields a less regressive and more defensible tax structure for financing government obligations. As payroll taxes for Social Security are trimmed, however, other sources of federal revenue must be found to replace them. Otherwise the already bloated federal deficit would mushroom still further.

Objections to Advance Funding

Opponents of partial advance funding of Social Security or of modifying fiscal policy so that the Social Security surpluses are saved have advanced several arguments. Two of the principal arguments are economic and one is political. I shall conclude my statement with a brief review of these arguments.

Elimination of Treasury debt held by the public. By law, reserves held in the Trust Funds can only be invested in Treasury securities or Treasury-backed securities. Swelling reserves in Social Security have given rise to a new and largely unfounded set of worries about managing the Trust Fund surpluses. Some people even suggest that the reserves will grow so large they could swallow up all Treasury debt, leaving no government securities in the hands of the general public.

This concern is ludicrous. Even though Social Security and Medicare are running large and growing surpluses, the remainder of the federal budget is running even more massive deficits -- and those deficits are climbing faster than the Trust Fund surpluses. The supply of federal debt is more than sufficient to satisfy the demands of all potential lenders, including the general public as well as the Trust Funds. This will be true for decades to come, no matter what financing method is chosen for Social Security or what budget policy is adopted. An era or unprecedented peacetime deficits seems a curious time to sound the alarm about disappearing Treasury debt!

Assuming that the Nation chose to build up massive Social Security reserves and modify federal budget policy so that the additions to reserves actually added to national savings, there might come a time three or more decades hence when Social Security reserves approached or exceeded Treasury debt. I regard this as an extremely remote contingency -- about as likely as frostbite while paddling on the Nile. In the unlikely event that Treasury debt in the hands of the public reached dangerously low levels, Congress could modify Trust Fund investment policy to permit investment of reserves in uncontroversial government-backed or otherwise insured obligations (such as student loans or mortgage-backed securities). If it is necessary, Trust Funds could even be invested in a portfolio of investment-grade corporate bonds or highly rated corporate stocks.

Fiscal drag. Some analysts object to large Social Security surpluses and associated high government saving out of fear of fiscal drag. Robert Eisner has argued, for example, that a sizable increase in government saving will reduce private spending by consumers and businesses rather than raise private investment. Instead of yielding a greater capital stock, the policy would yield economic slowdown. While this concern is a legitimate one in the short run, the economic record provides scant evidence suggesting that high government saving in the long run will harm economic growth. To avoid severe short-term dislocation I therefore favor a gradual move toward a high-saving fiscal policy.

Keynesian economists have traditionally viewed saving in any form with some ambivalence. On the one hand, saving is necessary if the Nation is to increase its capital stock and productive capacity. On the other hand, saving threatens full employment because it represents a decision not to spend. If saving exceeds investment requirements, total spending might not be enough to provide a market for all goods and services that can be produced at full employment. Unemployment, idle factories, and slack investment demand would be the natural consequences.

While recessions continue to occur, modern economists are increasingly confident that sound monetary policy and induced adjustments in investment and international trade balances are capable of generating sufficient demand by domestic and foreign households and businesses to maintain full employment at a wide variety of national saving rates. Countries, such as Japan, with rates of saving far in excess of our own have managed to achieve tolerable economic performance in spite of their lofty saving rate. In any event, fears of excessive saving in the United States today seem fanciful in light of current saving rates well below the historical norm -- and far below current U.S. domestic investment.

Political consequences of large reserves. Many analysts object to advance funding because they believe Congress and the public will be tempted to spend the surpluses on other government programs or on more generous Social Security benefits. These two criticisms will be considered in turn.

I share the fear that Congress and the President will find the Social Security surpluses a promising source of funds for non-Social-Security spending. As a practical matter, however, I believe it is unlikely that the current deficit in the non-Social-Security accounts can be explained by the large operating surpluses in Social Security. The non-OASDI deficits arose because of a budget policy change that occurred in 1981, well before surpluses developed in Social Security. In fact, the largest Social Security program -- Old-Age and Survivors Insurance -- was running major operating deficits in the early 1980s when the President and Congress decided to reduce non-OASDI tax revenues without reducing non-OASDI outlays by an equivalent amount.

Even though I am skeptical that the current imbalance in the non-OASDI budget accounts can be traced back to the surpluses in Social Security, I favor the proposal to remove Social Security surpluses from the budget targets defined under the

Gramm-Rudman-Hollings deficit reduction act. This proposal might place somewhat more pressure on Congress and the President to reduce the non-OASDI deficit. If this action is taken, the growing reserves in the Social Security Trust Funds might actually serve their intended purpose of raising national saving and improving the Nation's capacity to pay for future benefits.

There are many opponents of removing Social Security from the Gramm-Rudman-Hollings budgetary targets. The most common criticism of the proposal is that it would eliminate current restraints on Social Security spending. If Social Security spending does not count in measuring the Gramm-Rudman deficit, why would Congress refrain from liberalizing Social Security benefits?

This argument is frequently advanced by economists, politicians, and editorial writers. Very few of them appear familiar with the restraints on Social Security spending that have been reasonably effective over the past half century. The principal constraint on Social Security spending has not been the Gramm-Rudman deficit targets, which were only enacted into law in 1985. The primary constraint has been the obligation of Congress to find a source of revenue every time it substantially liberalizes the Social Security benefit formula. Congress (and the Committee on Ways and Means in particular) has always taken seriously its obligation to maintain the short- and long-run solvency of the program. Short-term solvency is threatened whenever Trust Fund reserves dip to a dangerously low level relative to average monthly obligations. Long-run solvency is in doubt whenever assured revenues fall short of benefit committments over the next 75 years by more than 5 percent (as they do under the II-B demographic and economic assumptions today). So far as I know, Congress has never liberalized Social Security benefits when the short-run or long-run solvency of the program was in jeopardy.

For this reason, I think concern over unwarranted liberalization of Social Security benefits is largely unfounded. The main problem in the federal budget is not that Social Security benefits are too high or Social Security taxes too low; the problem is that non-OASDI taxes are too low to pay for non-OASDI spending. To allay the public's fear that benefits might be unjustifiably liberalized, I favor legislative proposals that would require Congress to raise OASDI taxes or reduce other OASDI outlays whenever a significant liberalization of OASDI benefits is enacted. As a practical matter, however, I do not believe this legislation will have much effect: In determining the level of Social Security benefits, Congress has long followed this principle anyway

**Responses to Representative Edward R. Roybal**
**Chairman, Select Committee on Aging**
**U.S. House of Representatives**

by

Gary Burtless[1]

1. Robert Reischauer has stated that "increased reliance on social insurance payroll taxes is the major explanation for the reduced progressivity of the tax system." While I agree with Reischauer that the rising importance of social insurance taxes -- especially Social Security payroll taxes -- is an important explanation for the declining progressivity of taxes in this country, I think there is another important explanation as well: The declining progressivity of the personal income tax system and the declining significance of the corporate income tax as a source of federal revenue.

In his Presidential Address to the American Economic Association, published in the March 1990 American Economic Review, Joseph A. Pechman showed that a major reason for the decline in progressivity over the past two decades is the sharp drop in effective tax rates on individuals and families at the very top of the U.S. income distribution. From 1970 to 1988, the effective tax rate on taxpayers in the top 5 percent of the distribution fell from 33.0 percent to 27.4 percent of their total income. The tax rate on persons in the top one percent of the distribution fell from 39.0 to 26.8 percent, a drop of 12.2 percentage points (or nearly one-third). Meanwhile, people in the remainder of the distribution faced unchanged or slightly higher effective tax rates.

The sharp drop in the effective tax rates faced by people at the top of the distribution cannot be explained by changes in social insurance taxes. Families at the top do not pay any social insurance taxes on extra income they receive, and they did not do so in 1970. Consequently, changes in the personal and corporate income tax system are the main explanations for reductions in tax burdens in this very well-to-do group.

The tax structure can be made more progressive in two very simple ways. First, personal and corporate income tax rates could be raised, thus reducing or eliminating the deficit in the non-OASDI budget. Since the federal income tax is the main progressive element in the Nation's

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tax system, any reform that increased reliance on this source of revenue would raise overall progressivity.

Second, the income tax system could be made more progressive, for example, by raising the top marginal tax rate from 28 percent to 33 or 35 percent. Some income tax reforms that have recently been proposed, such as the proposal to limit the amount of capital gains subject to income tax, would obviously reduce the progressivity of the income tax.

2. The proposal to reduce the Social Security payroll tax, recently advanced by Senator Daniel Patrick Moynihan, would reduce federal revenues by $62 billion over the next two years and hundreds of billions of dollars over the remainder of the decade. In the short run, government fiscal policy would be more stimulative, giving a boost to U.S. personal consumption and the overall economy. In the longer run, the reduction in federal revenue would substantially raise the government deficit, raising interest rates, reducing private investment, and decreasing the pathetically small share of national income that is invested in plant, equipment, and public infrastructure.

One way to offset the inevitable rise in the federal deficit is to raise non-Social-Security taxes. If Senator Moynihan's proposed payroll-tax cut is adopted, I would certainly favor a policy of raising personal and corporate income tax rates. Alternatively, Congress could reduce federal spending by the amount of the payroll-tax cut, although this would involve enormous budget cuts by the end of the decade. One possibility is a cut in defense spending. Another is a cut in Social Security and Medicare benefits. Such benefit cuts could be justified if the payroll tax is cut. OASDI has expected revenues over the next 75 years that cover just 94 percent of expected outgo. If the payroll tax is cut, revenues would represent an even smaller percentage of projected outgo. Thus, benefit promises could be trimmed in line with the reduction in revenue.

3. Assuming the OASDI payroll tax is cut as much as Senator Moynihan proposes, Social Security would be returned to a pay-as-you-go financing basis. This is good news for today's taxpayers, but bad news for tomorrow's wage earners. According to the intermediate (II-B) projections of the Social Security Trustees, the cost rate for OASDI will rise from 10.25 percent of payroll in 2005 to 15.23 percent in 2025 and 16.61 percent of payroll in 2035. Under a pay-as-you-go system in which future beneficiaries receive the pensions they are promised today, this means that payroll tax rates for OASDI would have to rise 5 percentage points (about 50 percent) in the twenty years after 2005 and 6-1/2 percentage points (about 62 percent) in the thirty years after 2005.

Of course, there is some likelihood that benefit promises will not be kept. Future taxpayers may rebel against paying 16-17 percent

payroll tax rates for OASDI (and 3-6 percent tax rates for HI) when the recipients of Social Security had refused to pay 12.4 percent during their own working careers! The grievance of future taxpayers would be legitimate. If the country returns to pay-as-you-go financing for Social Security, I think it quite likely that current taxpayers will receive substantially lower benefits than they are promised under present law. The problem is, we do not know how much lower benefits will be -- that depends on a political struggle that will not take place for several decades. This uncertainty obviously makes it difficult to plan for the baby boom generation's retirement.

**Responses to Representatives William J. Hughes and Marilyn Lloyd Members, Select Committee on Aging U.S. House of Representatives**

by

Gary Burtless[1]

Questions of Representative William J. Hughes:

1. If the payroll tax is reduced now, tax rates will have to be raised substantially in the future in order to finance Social Security retirement benefits owed to the baby boom generation. Assuming the OASDI payroll tax is cut as much as Senator Moynihan proposes, Social Security would be returned to a pay-as-you-go financing basis. According to the intermediate (II-B) projections of the Social Security Trustees, the cost rate for OASDI will rise from 10.25 percent of payroll in 2005 to 15.23 percent in 2025 and 16.61 percent of payroll in 2035. Under a pay-as-you-go system in which future beneficiaries receive the pensions they are promised today, this means that payroll tax rates for OASDI would have to rise 5 percentage points (about 50 percent) in the twenty years after 2005 and 6-1/2 percentage points (about 62 percent) in the thirty years after 2005.

Payroll taxes would not have to be raised this much if Social Security continued to be funded on a partially advance funded basis, and the current payroll tax rate were maintained. Future tax rates could be lower under an advanced funded than under a pay-as-you-go system because a large share of future benefits would be financed out of interest earnings on the trust fund reserves. Under a pay-as-you-go system, interest earnings on reserves would be low.

Of course, there is some possibility that benefit promises will not be kept if Social Security reverts to a pay-as-you-go system. Future taxpayers might rebel against paying 16-17 percent payroll tax rates for OASDI (and 3-6 percent tax rates for HI) when the recipients of Social Security had refused to pay 12.4 percent during their own working careers.

2. Use of the Social Security trust fund surpluses to pay for growing deficits in the non-Social-Security budget does not add to national

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saving. Using the surpluses in this way is like setting aside $1000 a year in a retirement fund, but then borrowing all the money in the fund to take an annual vacation. Your vacation debt of $1000 exactly offsets your $1000 retirement savings account, so there is no net savings to pay for your retirement. The Social Security surpluses would add to national saving if their accumulation resulted in a steadily falling amount of federal debt held by private savers.

The fact that the current surpluses do not add to national saving causes two kinds of problems, one of them economic and the other political. The economic problem is this: The country now has a pathetically depleted pool of savings, caused by high federal deficits and limited private saving. This problem has led to two further problems in the past decade. The Nation has to import a sizable amount of savings from abroad to maintain private investment, leading to enormous deficits in our balance of trade. And even with massive borrowing from abroad, net private investment in this country -- measured as a percentage of national income -- fell in comparison with earlier decades. The country became a net borrower, and it did not borrow enough to maintain the rate of investment. Yet if the standard of living of future workers is to be maintained after the baby boom generation retires, the Nation will need more investment than ever.

The second problem is political. The public is gradually becoming aware of the fact that Social Security surpluses are not adding to national saving. As that awareness sinks in, younger workers may become persuaded that the Trust Fund reserves are not real and therefore do not assure that future benefit promises will be kept. A major political problem of Social Security in the recent past was the conviction on the part of younger workers that Social Security benefits would not be affordable or available when they retire in the next century. For obvious reasons, this conviction undermines the political popularity and sustainability of Social Security.

3. It would be possible to save the trust fund solely for the retirement of the baby boom generation, but I do not believe it would be desirable to do so. That is, the Nation could accumulate vast trust fund reserves and then deplete those reserves between 2025 and 2050, by which time most of the baby boom generation will be dead. After 2050 Social Security could once again be financed on a pay - you-go basis.

I believe, however, that this funding scheme would be foolish. During the years the trust fund is depleted (2025-2050), national saving would fall far below the level it would attain even under a pay-as-you-go system. All of the extra national saving that had been accumulated between 1990 and 2025 as a result of the advance funding system would be dissipated. Capital stock per worker and worker productivity by 2050 would be no higher than it would have been without the sacrifice of wage earners between 1990 and 2025.

It would be preferable to pay for all future Social Security benefits under a partially advance funded system, including the benefits that will be paid to children, grandchildren, and great-grandchildren of the baby boom generation. Under this funding mechanism, surpluses in the Social Security trust fund will always add to national saving and investment, and worker productivity will always be above the level it would attain under a pure pay-as-you-go system.

Questions of Representative Marilyn Lloyd:

1. Use of a progressive tax to finance Social Security benefits would reduce the burden of financing future Social Security pensions on most workers. But reliance on a progressive tax would raise the burden imposed on other workers, particularly high-wage workers.

While I have no objection to paying for Social Security benefits with a progressive tax, I suspect that this kind of funding mechanism would, in the long run, undermine popular support for the program. The popularity of Social Security and the payroll tax mechanism that sustains it is quite widespread. The benefit package is quite progressive. Combined pension and Medicare benefits are much higher in relation to contributions for low-wage than for high-wage workers. And the tax formula is strictly proportional for wage earnings below $51,300 per year. This combination of progressive benefits and proportional taxes is widely perceived as fair, because tax payers can see a direct link between their current taxes and their future benefits. If the tax formula is made progressive, support for Social Security among high-wage workers might suffer.

2. From an economic standpoint, it does not matter whether some Federal Government revenues are labeled "trust fund revenues." From a legal standpoint it matters a little bit. Money in the Social Security trust funds represents legal spending authority for Social Security benefits. Thus, a specific Congressional appropriation is not needed to spend the money in the trust funds on Social Security benefits. This places Social Security spending on a somewhat different footing than, say, spending in the food stamp or Aid to Families with Dependent Children programs, where annual budget appropriations are needed.

Chairman ROYBAL. Thank you, Mr. Burtless. The discussion has been most interesting. I'd like to state what I believe to be the important parts of your testimony. They're all important, of course, but I was interested in the positions taken by the three of you.

Mr. Myers, for example, is in favor of pay-as-you-go. He is for the Moynihan plan. Mr. Ball and Mr. Burtless are against pay-as-you-go and do not favor the Senator's plan. I would like to have Mr. Ball and Mr. Burtless tell me and the committee, why Mr. Myers is wrong. Then, I'm going to ask Mr. Myers to tell us what his position is and why he thinks Mr. Ball and Mr. Burtless are wrong. We might be able to get some information from that discussion that would be most beneficial. I will ask Mr. Ball first, and try to condense your response as much as possible. I know this is an important subject, and it is very difficult to do, but, if we can, let's try to do that.

Then, we'll have a discussion among the members of the committee, and then ask questions.

Mr. Ball.

Mr. BALL. Mr. Chairman, I don't think I want to say categorically that Mr. Myers is wrong. I think the pay-as-you-go system will work for Social Security, but the reason that I don't favor it, and the reasons I don't favor the Moynihan bill more specifically, are as follows:

One, we give up the possibility of using Social Security surpluses to increase the pool of goods and services that support retirees of the future. Second, as a matter of political reality, I think the big increase that is required in a pay-as-you-go system between 2012 and 2025 when the baby boom generation is retiring raises the real possibility that workers then may well say, "Well, why should I pay rate increases of 50 percent to pay benefits to people who have been paying the lower rates?" I would think there would be a much better chance of maintaining the level of benefits now promised if retirees at that time had come close to paying their own way.

Now, I don't want to overstate that. We have been honoring Social Security promises even though people who are receiving them today have not paid their own way. However, the steep increase of going from a 5.1 percent rate to 7.7 percent, in a 13-year period, from 2012 to 2025—seems to me could well lead to cuts in benefits as well as increases in contributions.

Those are my main reasons. I would like to stress one point where we do agree. That is we all believe that the huge buildup and then the dissipation of the fund, the result of present law—and it is an accidental result of other decisions—is not the best approach to reserve financing since once the babyboom generation causes the system to reach a new cost plateau that new level is going to continue. I would propose a rate increase in 2020 to 7.1 percent to maintain the reserves on through the whole 75 years over which these estimates are usually made. You would still end up in 2065 with a reasonable contingency reserve.

Chairman ROYBAL. All right. Mr. Burtless.

Mr. BURTLESS. A pay-as-you-go funding system for Social Security does not increase confidence in today's workers that tomorrow's benefits are going to be paid. I think that is one of the main advan-

tages of a partial-advanced-funded system. It is a political advantage; it is not an economic one. We can debate about whether having reserves actually does increase the likelihood that benefits will be paid but, since 1982 there has been a resurgence of confidence that Social Security benefits will be paid. It is still pathetically low, I think, amongst American workers under the age of 35. But the confidence of these workers in the system, I think, is very important. A pay-as-you-go system does not appear to provide very much basis for confidence that workers will receive benefits in the next century.

The second point is that a pay-as-you-go system does not in any way contribute to national saving. We know that the obligations of the system in the next century are going to rise, and an increase in national saving would help reduce the burden on tomorrow's workers of paying for those retirement benefits.

I agree that, under the current system, where the surpluses in Social Security simply offset equal or even larger deficits in the remainder of the Government, we are not raising national saving. But that is what I think we should attempt to do, and we should leave the current Social Security funding in place.

If we want to give up on the possibility that we can restore discipline to the remainder of the Federal budget, then I jump ship, and I abandon my advocacy of advanced funding of Social Security because it really doesn't make any difference. I would then support Senator Moynihan's plan with one proviso, and I think it is an important one: Replace the lost Federal revenue that would come from cutting the payroll tax with increased revenue from some fairer source of funding or reduce spending. Don't make the Nation's saving problem even worse than it already is (and it is very bad). We have very low saving compared to our trading partners and very low saving compared to even our own historical experience before 1983. Let's not make it worse by tossing out hundreds of billions of dollars of Federal revenue over the next decade.

Chairman ROYBAL. Thank you.

Mr. Myers.

Mr. MYERS. As far as confidence in the system goes, I disagree with Mr. Burtless. I think that much confidence has been destroyed or at least has not been restored, because people think that money is being stolen or embezzled from the trust funds. I think that confidence would be restored if the American public were assured, as President Reagan said when he signed the 1983 amendments, that people of good will of all parties are going to see that the Social Security system continues under any circumstances. If people realize that the program is going to be financed on a pay-as-you-go basis out of the tax revenues as of each year, I think that they would have more confidence in the system.

Now, as to the large increases in the tax rate that would be necessary under pay-as-you-go over the long run, I do not view these as very difficult to achieve. There have been much larger tax rate increases in the past. They have gone into effect, and there were not political repercussions from them. The point is that, even under present law, at some point, as I have indicated, the trust fund becomes exhausted (or very low), a very large increase in the tax rate will be needed at that time. I think that it is being more

responsible to face up to the issue and to have gradually increasing rates as the money is needed to pay the benefits.

As Mr. Ball suggests, and I would agree, certainly if a large fund will be built up, it should not be allowed to vanish under a system that will have the same relative level of costs out over the future, and not decrease when the babyboomers depart the scene. At that point, there must be higher tax rates, and they are not too far below those that are in Senator Moynihan's bill.

In other words, I say that having a huge fund of $12 trillion does not really do much good. The interest that it provides is mostly used to maintain its size, and it is not really cost efficient as far as financing the benefits are concerned.

I think that, if we say, "We must use the Social Security system to promote savings in the country," we are having undue lack of confidence in the American public. They ought to face these issues fairly and squarely, and they ought to save, or be educated and encouraged to save on their own and not have to hide behind the screen that this is being done through the Social Security system.

Furthermore, if measures are taken to balance the budget, and to reduce the huge outstanding debt that is so rapidly growing, then there will not be the burden on the taxpayers in the years when the babyboomers are retired, so that they can afford to pay directly for Social Security by slightly higher payroll tax rates, and not do it through the hidden manner of redeeming a debt that is being incurring today and that should not be.

Thank you, Mr. Chairman.

Chairman ROYBAL. Mr. Hughes.

Chairman HUGHES. Thank you very much, Mr. Chairman, and thank you members of the panel for some very, very interesting and very helpful testimony.

Frankly, I am concerned about the intergenerational aspect of the problem. One of the reasons why we have this large bubble is because we have such a large class of beneficiaries that will be receiving benefits beginning in the year 2010. Isn't there a compelling reason for us, if we believe that basic equity has to be done to workers as well as retirees, that we in fact raise sufficient monies to attend to those needs, have the age cohorts that will be benefitting from those benefits pay for them during their working years? Isn't there a compelling equity issue involved here?

Mr. Ball.

Mr. BALL. That is a very good point. Remaining at the 6.2 percent level now being paid largely finances the retirement benefits and other Social Security benefits of the new contributors. I think that is a strength of the system and people can depend on Social Security more because of that.

It also means that you don't have to face in such a dramatic way, as you do under pay-as-you-go, the later issue of benefit cuts versus tax increases. I was suggesting a tax increase in 2020 of from 6.2 to 7.1. Under pay-as-you-go and the Moynihan bill, you go from 5.1 in 2011 to 7.7 in 2025. That, I think, will raise the questions. "Well, these other people have only been paying at 5.1, how about cutting their benefits instead of raising my taxes so much." I am afraid this will increase intergenerational pressures between present contributors and their children, which I don't want to see happen. We

should smooth out the rates—keep 6.2 and go to 7.1—not drop down to 5.1 then back up to where we are and beyond—7.7 percent in 2025 and 8.1 percent in 2045, as required by pay-as-you-go.

Chairman HUGHES. Precisely. You know, Mr. Myers, I don't think it is a matter of having confidence in the American public's ability to save. I mean, we have demonstrated that we're not the best of savers in years past, and I'm not so sure I see anything on the horizon that is going to change that.

One of the things that troubles me about a pay-as-you-go proposal is that you would be proposing some significant increases in the early part of the next century, the year 2010 and beyond. At the same time, you are reducing the amount that the generation that will be collecting those benefits contribute to their pensions. Doesn't that do some violence to the basic concept of generational equity? Isn't it going to put the pressures, basically, on the Congress and other decisionmakers to perhaps either cut benefits or in some other way finance some of the increases in another fashion besides the payroll tax?

Mr. MYERS. Mr. Hughes, I think that one should take a much broader look at what generational equity is. A social insurance system is not, by any means, an individual-equity program, under which everybody gets their money's worth out of it—no more, and no less. If the program had been set up that way, it would not have been as effective as it has been over the past 50 years.

If one looks at the matter of generational equity, one should also look at the question of generational equity today, when the deficits are not being reduced, by building up such a huge debt, and by putting it in the Social Security trust funds to hide it. As a result, in the year 2020 there is going to be a huge problem of repaying the debt that is put on the taxpayers of that day.

So, whether they pay for it in payroll taxes or in debt reduction taxes, they are going to have it either way.

Chairman HUGHES. See, I don't think that the way we mask the Federal deficit is necessarily connected with the balance of the proposal. I favor very strongly, number 1, attempting to be a lot more honest about our Federal debt, our non-Social Security debt, than we have been in the past. Second of all, unless I could be assured that we are in fact going to balance our budget and eliminate our current deficits, which basically represent a major drain, I would want to make some major structural changes.

If we're looking at a total integrated budget whereby we are going to finance Government debt out of current revenues, which is what everybody says they want to do, then we are truly going to have a surplus out of which savings can help expand that pie that we all talked about. Isn't that a good plan? Why tamper with that at this point? Why resort to a pay-as-you-go approach which basically only ends up transferring most of our problem with regard to the babyboomers to the year 2010 and beyond? Why not address it now?

Mr. MYERS. There is the other element that I mentioned. I think that, if a large fund is built up, and people think that it is there available to spend, not that it is to be saved to be spent later when the babyboomers come along to retirement, they will want to spend it at the moment.

Chairman HUGHES. That troubles me.

Mr. MYERS. And there will undue benefit liberalizations.

Chairman HUGHES. That troubles me. How do we deal with that, Mr. Ball? That troubles me greatly that that could happen, that pressure.

Mr. BALL. I don't want to minimize that possibility, but I want to direct your attention to the history of the Congress on this issue. I think it is one to be proud of. Over the last 50 years, the Congress of the United States, which is usually characterized as having a time horizon of 2 years, has not acted that way at all in relation to Social Security.

I have been in every conference between the House and the Senate from 1950 up to 1972, and in each of those conferences the issue wasn't only the short run costs from the changes being made in the program but the long run costs. The conferees turned to the professional actuaries, civil servants of the Government who are very independent-minded people, I can assure you, and asked them on every occasion, "Is the system now in long-range balance?" If it wasn't, they went to work and made modifications in their proposals to bring it into a balance over a 75-year period.

Now, maybe future Congresses won't be as responsible, but there is a long history of keeping the system in long-range balance. I believe it is important that we continue to have a measure of what constitutes close actuarial balance so that you can continually look at it and see that the system is kept in balance over the long run.

I would be willing to rely on the good judgment and responsibility of the Congress to see that those reserves were treated as reserves and not available funds. I don't want to, on the other hand, say that I'm absolutely positive of that. Bob's point that there is a temptation either to liberalize benefits or to spend more in the general budget because of the easy availability of borrowing from Social Security has merit. I just think, on balance, that this point is overwhelmed by the other considerations.

Chairman HUGHES. Thank you.

Chairman ROYBAL. Mrs. Morella.

Mrs. MORELLA. Thank you very much. I am really amazed that this committee is still meeting. I have already been to three other committee meetings, which indicate the importance of the subject and the talents of the panel.

Mr. Myers, you are a constituent of mine. I am very honored that you are here, and Mr. Ball, and Mr. Burtless also.

Actually, I remember reading a document sometime ago that was put together by some economic advisors. It may have been part of a transitional team report, It talked about what we do to balance the budget. They came to the conclusion that the Social Security trust fund surplus should be considered as part of the budget deficit and that what we should do is simply expand the period of time to come up with a balanced budget and just consider it as we are—not taking it off budget, but just consider it to be part of the deficit. That was the best they could come up with when asked, "What do you do about that?"

I just wondered if you have an opinion on that. Forgive me if you have already gone through that many times.

Mr. BALL. You've hit on a point that the three of us probably agree on, which is not true of most of the other things that have come up. I believe all three of us think that the Social Security calculations should be taken out of the Gramm-Rudman targets. Actually Social Security is now off budget for all other purposes but Gramm-Rudman targets and would be removed completely at the end of the Gramm-Rudman legislation.

I think the three of us believe that the solution that advisers came up with was not the right one, and that you shouldn't count Social Security surpluses as a way of meeting the overall budget deficit.

Mrs. MORELLA. So what Senator Moynihan, and I guess you were the architect of that plan, has really contributed, differences aside, is a truth-in-budgeting kind of idea. Then you go one step further and you say, "Hey, we've got some other trust funds." I mean, we've got a highway trust fund and an airport trust fund. Should we do the same thing with them?

Mr. MYERS. I would think so. If they are really set up as a trust fund, and the money is to be used for that purpose, then—

Mrs. MORELLA. It is dedicated.

Mr. MYERS.It should be, and the rest of the Government should get its budget in balance the way Social Security has. One thing that I have always pointed out is that in the over 50 years of operations of the Social Security system, it has had a balanced budget. The problem is the rest of the budget of the United States.

Mrs. MORELLA. But you all would also agree that you don't actually take Social Security off budget statutorily, or do you?

Mr. BURTLESS. Well, it is off budget statutorily today. But it is counted in the Gramm-Rudman targets.

Mrs. MORELLA. Right. But we took the postal system off budget. There have been movements, in fact there is legislation in, to take Social Security off budget. I just wondered if you have a feeling about that. We can do it computationally, but to literally take it off budget I think may pose a different series of—

Mr. BURTLESS. Well, if we do that, I think that the current Gramm-Rudman targets should be amended because they currently are on a path that takes us to zero in 1993, including the surpluses in Social Security. That would be an awful lot more fiscal stress, perhaps, than you want to give the economy when it's already slowing down. You don't want to remove that much Government spending from the macro economy that fast.

If you have a balanced budget in the remainder of the Government accounts, in the non-OASDI accounts, by 1996 or so, that would be perfectly okay with me.

Mr. MYERS. I believe that, if Social Security is taken out of the budget, as I think it should be, it then requires a rethinking of the Gramm-Rudman-Hollings law and targets. But I think that is all to the good, I think that is one of the strengths of Senator Moynihan's proposal, which is to get people to really face the issue and not have it be partially disguised by the operations of the Social Security system.

Mrs. MORELLA. I think he has done that, but I must say, I saw him on Meet The Press when this proposal first came out, and Leslie Stahl was questioning him, "But Senator Moynihan, now

that's going to be $55 billion that you're not going to have there. What are you going to do about it?"

Mr. BURTLESS. Well, it might be true that he looking is looking in the right direction. But he is walking backward.

Mrs. MORELLA. Right. He couldn't explain what he was going to do. And then it was like, "Well, would you go along with Senator Hollings' suggestion to raise taxes?"

Mr. BALL. You certainly have to look at these things together. You can't just reduce Social Security taxes unless at the same time you consider whether you're going to increase other taxes or cut other benefits. Otherwise you just increase the deficit problem that we have overall.

Mrs. MORELLA. I thank you very much, and thank you for being generous with your time, Mr. Chairman.

Chairman ROYBAL. Mrs. Lloyd.

Mrs. LLOYD. Thank you very much, Mr. Chairman. A lot has been said about using some of our surplus to put more money into the Social Security trust fund. Would this be possible under our current approach?

Mr. MYERS. It could be done. Monies have been moved back and forth between the disability part and the old-age and survivors part. What you suggest would have to be done by a change in the law. My position on the matter is that the two systems should be considered separately. When the Hospital Insurance system needs more money, as it may in 5 to 10 years, at that time, determine what should be done. At that time, it might be decided to reduce benefits some or only to increase taxes?

Either way is acceptable, but I think that the two programs should be considered independently, and at this point, large amounts should not be transferred to the Hospital Insurance program because it might need money in the future. Let's wait until the time comes.

Mr. BALL. I would favor moving part of the tax rate from OASDI to hospital insurance only if a decision were made that you wanted to put OASDI on a pay-as-you-go basis, which is not what I favor. I'm saying, even if you do go pay-as-you-go, let's not reduce the overall Social Security contribution rate. Hospital insurance is supported by part of the Social Security tax and there is a near certainty problem of under financing in hospital insurance.

Mrs. LLOYD. I read your article when it came out in the Post.

Mr. BALL. I haven't changed my mind.

Mrs. LLOYD. Mr. Burtless, what do you think about the hospital insurance fund?

Mr. BURTLESS. Well, the argument for partial advanced funding for OASDI is that we can already see these obligations in the future because of the demographic future that is already determined by the birth rates in the past.

The same argument applies to part, not all, but part, of the spending that we can already foresee in the hospital insurance fund. Part of the increased spending is due to the aging of the population starting around 2010, and there is an equally-valid argument for partial advanced funding of those foreseeable burdens that the future taxpayers are going to have to bear.

I don't think that the argument is quite as strong in medical care spending because it is very unclear what medical care package we're going to offer after 2010. It could—

Mrs. LLOYD. We know it's not going to come down though.

Mr. BURTLESS. We know it's not going to come down, but we also might make very fundamental reform in the way we pay for medical care benefits after 2010. As I say, I think that there is an argument for partial advanced funding of part of the hospital insurance obligations.

Mrs. LLOYD. One final comment. Mr. Ball, I agree with you that we should go to a ratio of 100 to 150 percent, but when we're spending all of our money, how can we get there?

Mr. BALL. Well, as Mr. Myers testified earlier, we are very likely to get to the 100 percent of the next year's outgo at the beginning of next year if things go well in the economy. We will probably get to 150 percent between 1993 and 1996, depending on the performance of the economy. These are all estimates based on percent tax rates. It will happen automatically.

I am so concerned about the threats to confidence in the Social Security system from what happened in the mid 1970s and early 1980s that I want to see us at 150 percent before we advocate action reducing income to OASDI even under pay-as-you-go.

Mrs. LLOYD. Aren't we spending the payroll taxes that are coming in?

Mr. BALL. Oh, I'm sorry. I misunderstood. I thought that—

Mrs. LLOYD. How are we going to reach the surplus when we're spending all of it?

Mr. BALL. Well, what we're doing is lending the money from the Social Security trust funds to the general treasury which, it is true, is spending the money on a variety of Government programs and paying interest for that borrowing. The ratio that we are talking about for a safe trust fund level is not really affected by that procedure.

Under a pay-as-you-go system, if we were to go to that, which I'm not for, the annual excess of income over outgo in Social Security would not be very large. It would only be sufficient to maintain whatever ratio of funding to benefits you decided was a safe ratio. A lot of this problem of so-called "masking the deficit" just doesn't occur under pay-as-you-go. This problem of the treatment of Social Security annual surpluses in the deficit is important if we continue on a path of partial reserve financing when these annual amounts of excess of income over outgo are very large. Then, I think it becomes very important that we make sure that we are really contributing in basic economic terms to an increase in the savings rate and an increase in the pool of goods and services later.

We are handling the Social Security accounts the same way now as they have been handled since the beginning of the system. What we've been doing is invest the money in government securities. The Treasury has used the money for a variety of Government purposes and paid interest. That becomes a problem, I think, only when you talk about very large-scale reserve financing. Most of this buildup is in the future.

Senator Moynihan, I think, jumped the gun a little bit. In the Economic Commission, of which he was a member, the Democrats

on that commission in a report that I think was written largely by him—it has his style certainly and it was very good—said that if we continue the way we're going for another 5 years, you can depend on it that Congress will go to a pay-as-you-go system. They won't put up with, in effect, using the payroll tax to support current operating expenses of the Government. He only waited 1 year. He's got another 4 years of that original prediction and I don't think it is right now a big problem.

Mrs. LLOYD. Thank you, Mr. Chairman.

Chairman ROYBAL. All right.

Mr. DeFazio.

Mr. DEFAZIO. Thank you, Mr. Chairman. Back to the intergenerational equity question. That is my primary concern, and Mr. Reischauer just blew it off in the first round of questions. I didn't get a second round, which isn't to say, "Oh, we just walk down the hall and cash in the bond." Okay, how do we pay for cashing in the bonds at that time? That is the key to the question of this intergenerational equity. There are some who advocate, well, we raise it through a progressive tax, not a regressive tax, which means an income tax, which means that the retirees, the babyboomers who are going to have taxable retirement income outside of Social Security, and part of their Social Security may be taxable depending on what we've done with that, are going to end up paying a higher rate now in taxes and then pay for their own retirement, or you can do it by raising the so-called regressive tax, the Social Security FICA tax, and raise the money there.

One way or another you're going to have to raise taxes sometime after 2010, no matter which option you follow here, in order to pay either for the IOUs or for the pay-as-you-go system. One way or another you're going to have to do it, and that is the crux. It's not intergenerationally equitable if you fund it now with an increased FICA tax and later with an increased income tax which is paid by the same people who paid the increased FICA tax now. How do you respond to that? How are you going to do it? How are you going to redeem them? How do you pay it?

Mr. BALL. There are 3 or 4 strands in the questions you have raised. Let me get out of the way a point that is relatively superficial. That is, as far as my own proposal is concerned, I wouldn't cash in bonds. I would put a Social Security tax increase into effect in 2020 that is sufficient so you don't have to cash in those bonds for at least the next 70 years. You are maintaining the trust fund if you go to a 7.1 percent rate in 2020—actually building it somewhat further. I think this build up and then cashing in—the rollercoaster effect of present law that Bob talks about, is not sensible.

Mr. DEFAZIO. Even cashing in, but interest coupons also have to be—you've got to redeem your interest.

Mr. BALL. It is a relatively superficial point I was making as compared to your basic problem.

Mr. DEFAZIO. Right.

Mr. BALL. Fundamentally, there is no way out of the fact that retirees of the future will be supported by the goods and services produced in the future except for the perhaps minor exception that, at least for a time, the movement of capital and goods in the international markets might make it possible for us to partially

support our retirees from that source. But we are actually going in the opposite direction and making it harder for ourselves rather than easier by borrowing from abroad rather than investing abroad.

With that exception, retirees have to be supported out of the goods and services produced by the U.S. when the retirees use them. The only thing we can do to make their support easier is to take steps now that increase later production. One way of doing that is to increase the savings rate. The easiest way to increase the savings rate is by government action to reduce the deficit and later build a surplus. I think that is the fundamental basic point to hold onto, rather than—

Mr. DEFAZIO. right. But I just think a Social Security tax isn't necessarily the best way. I mean, it can also be brushed off. We have tried other things to raise the savings rate. We have the IRAs. We haven't tried a lot of very innovative things to raise savings rates.

Mr. BALL. You mean the private savings rate?

Mr. DEFAZIO. Well, I mean, you're looking at an aggregate savings rate.

Mr. BALL. Yes.

Mr. DEFAZIO. I mean, overall the whole—

Mr. BURTLESS. Can I take a different stab at answering your question about equity which I, actually, in my original testimony, put in as one of the three reasons that you want to have partial advanced funding.

First, Bob made the right point. It is very unlikely that this pattern of buildup and spenddown will be observed. The reason is: When you get out to 2020, Congress will be looking at a system that will have a gigantic imbalance between foreseeable obligations and foreseeable revenues in the next 75-year period, a huge imbalance.

We already have slightly more than a 5 percent imbalance and too little revenues to pay for expected costs. If we don't do anything between now and 2020, the imbalance will be gigantic. It's inconceivable to me that Congress would permit that to go on for very long. They have never permitted it in the history of the program. That is not going to occur. That means that tax rates will be raised, or benefits will be trimmed, at some point in the future, to bring the system closer to long-term balance.

Both Bob Ball and I favor eliminating the general fund deficit today. That means either the current generation will be receiving less services from the government or they'll be paying more taxes to pay for the services that they receive. Because we already know that the baby boom generation, under the current tax schedule, is going to receive back about as much in Social Security benefits as it pays into the system, there is no inequity for that generation in what it is receiving under Social Security and what it is paying. It is paying about for what it is going to receive.

It is true that the Social Security payroll tax would have to go up sometime in the future to maintain that current schedule of benefits, but that is because life expectancies are going to rise, so those future generations that pay the higher tax rates will be receiving benefits over a bigger portion of their life. They'll be receiv-

ing more expensive medical care treatment. I don't think that there will be this inequity in practice from a partial advanced funded system.

Mr. DEFAZIO. The other point is we talked about the security and inequity, you get back to this point that I think is also very troubling about the point at which the balance of the trust funds exceeds the Federal debt in some way.

Now, the point is, if you go and you look at 2010 in the report, you are going to have $271 billion in interest payments to ourselves for Social Security at the same time that we're accumulating another $160 billion surplus because of current funding or because we're on the pay-as-you-go system.

The question is, I could say to myself, If I'm a politician in 2010, I can reduce this year's net expenditures by $91 billion by saying that, "I've just wiped out debt to Social Security, and we're going to go to a total pay-as-you-go system here, and we no longer are going to pay ourselves interest; that debt doesn't exist anymore," with the stroke of a pen. I mean, that is something that troubles me greatly, and I think we are saying, "Oh, this is so far off in the future, and this is academic, and, of course, the Congress can never do that." In that one year, it is going to mean $91 billion in gain to the Government because you bite down debt. The question is, yes, well then you've got to raise FICA tax.

I think that it is more complicated than your two positions are putting forward, much more complicated. I think the political permutations are far beyond what we can conceive today. I don't buy that just because we've supported it in the past we are going to support it in the future.

Mr. BALL. Does this help any, Mr. DeFazio? The Government is in a better position to meet the Social Security costs which will be the same—you don't change that; that is fixed—if—

Mr. DEFAZIO. If we don't reduce benefits.

Mr. BALL. Yes, but I'm assuming you have the same benefits. It is in a better position to meet those costs if it doesn't at the same time have to pay interest to Social Security trust funds and interest on a large debt held in private hands.

What will happen under partial reserve financing is that Social Security will own the debt that is now held in private hands, and it is true that you will have to pay just as much Social Security, but you will be in a better position by not having to pay interest at the same time on what is now a huge debt held by the public.

Mr. DEFAZIO. Right, but we'll be paying interest to ourselves.

Mr. BURTLESS. I don't think that there is a conundrum. I think that Bob has stated it right. If the rest of the Government is not issuing new debt between now and 2020, because there is balance in the general accounts of the Government, then the burden of paying for debt on taxpayers in 2020 is very minuscule relative to the size of the economy and relative to what the burden is today.

Today, 30 percent of GNP, almost 40 percent of GNP, is debt that is held in the hands of the public. More, I think, than all the deficit of the United States Government this year consists of interest payments being paid out. That would be eliminated or reduced if there were not any new debt.

The burden of paying for Government is substantially reduced—

Mr. DEFAZIO. In this area, we have to raise the money. I understand that, but you're raising the money through income taxes to pay the interest which you could wipe out with the stroke of a pen because you owe yourself the money. I mean, if you went back to your simple analogy, I don't know exactly how you'd construct this, but if you take that same guy and move him up to that year, and he has a debt of $150 a month that he has to pay, but he is paying it back to himself at some rate, I mean it would take a while to construct this, but you are going to get to a point where it doesn't seem totally logical.

Mr. BURTLESS. But that's why we favor balancing the current budget in the general budget of the Government, exclusive of Social Security, in the relatively near future. I think that—

Mr. DEFAZIO. I agree with that, but the question is, you know, do your plans for Social Security assist us in getting there? That is necessarily what I don't buy into.

Mr. MYERS. I certainly do not buy that either, because I think that, with the availability of all these monies from the Social Security system under the present financing basis, it causes less will and less incentive on the part of the Government to really balance the rest of the budget. I do not think that the Social Security system should be used for non-Social Security purposes either to encourage savings, which certainly should be done, or to balance the budget.

I quote something that J. Douglas Brown, who was one of the founding fathers of the program, said years ago that still holds today. He said, "The Social Security system should not be distorted into a mechanism for the manipulation of fiscal balances." I think that was true when he said it. I think it is still true. I think that this country should be forthright enough to face the budget problem and to face the savings problem and to solve them directly and not under the guise of the Social Security system.

Chairman ROYBAL. Well, Mr. Myers, I thought that after your statement, it would be a good time to adjourn, but I see that Mr. Ball has—

Mr. BALL. Just a quick point to make on J. Douglas Brown's views. He said what Mr. Myers said, but it reminds me that he was an advocate of a pay-as-you-go system, but only if the accrued liability assumed at the start of the system was later met by a general revenue contribution. In other words, instead of interest on a fund build-up he provided partial funding from general revenue under his approach a third of the cost of the system would come from general revenues. I don't think any of the three of us would support that today.

Chairman ROYBAL. I would like to thank the members of the committee for a very interesting hearing. There will be some additional questions that will be submitted to each one of you. I hope you can answer them as soon as possible.

We will hold the record open for two weeks. At that time, it will be closed, and a report will be submitted.

Thank you very much for your testimony.

The hearing is adjourned.

[Whereupon, at 1:10 p.m., the hearing was adjourned.]

# APPENDIX

STATEMENT OF THE HONORABLE TIMOTHY J. PENNY (D-MN1)
BEFORE THE SENATE COMMITTEE ON FINANCE
FEBRUARY 8, 1990

MR. CHAIRMAN: THANK YOU FOR THE OPPORTUNITY TO TESTIFY BEFORE YOUR COMMITTEE TODAY. AS A SPONSOR OF H.R. 3865, A BILL SIMILAR TO SENATOR MOYNIHAN'S, THAT WOULD RESCIND THE SOCIAL SECURITY (FICA) TAX INCREASE, I AM EXTREMELY INTERESTED IN THE PROGRESS OF THIS LEGISLATION.

ON MONDAY, YOUR COMMITTEE HEARD THE PROS AND CONS ON THIS ISSUE FROM SOCIAL SECURITY EXPERTS. SINCE I DON'T PROFESS TO BE AN EXPERT, I WON'T GO INTO DETAIL AS TO THE MERITS OF REDUCING THE PAYROLL TAX. HOWEVER, I WANT TO APPLAUD SENATOR MOYNIHAN FOR HIS DETERMINATION TO END THE "GREAT BUDGET CHARADE OF THE 1980'S."

IT IS CLEAR THAT THE ADMINISTRATION INTENDS TO CONTINUE TO ALLOW SOCIAL SECURITY REVENUES TO MASK THE DEFICIT AND FURTHER USE THE SOCIAL SECURITY PAYROLL TAX AS A CONTINUING SOURCE OF FUNDS FOR THE FEDERAL BUDGET. SENATOR MOYNIHAN'S PROPOSAL FORCES THE ADMINISTRATION AND CONGRESS TO BE HONEST ABOUT THE DEFICIT, AND TO TALK ABOUT HOW TO SET NATIONAL PRIORITIES AND GET TO A BALANCED BUDGET. AND TO ME, THAT IS THE REAL SIGNIFICANCE OF HIS LEGISLATION.

I AM WELL AWARE THAT REDUCING THE PAYROLL TAX NOW WOULD BE A "MIXED BAG." A TAX BREAK WOULD PUT MONEY INTO THE HANDS OF WORKING MEN AND WOMEN AND THAT MIGHT STIMULATE THE ECONOMY TO SOME DEGREE. BUT IT MIGHT NOT BE ENOUGH TO OFFSET THE EFFECT ON THE ECONOMY OF INCREASED GOVERNMENT BORROWING.

I STRONGLY FEEL THAT ANY REDUCTION IN THE FICA TAX SHOULD NOT BE DONE IN ISOLATION OF THE BIG PICTURE; THAT BEING A MORE FISCALLY RESPONSIBLE TREATMENT OF THE REST OF THE BUDGET.

IN FACT, IF WE WOULD BE HONEST ABOUT THE NEED FOR CUTS AND REVENUES IN ORDER TO BALANCE THE REST OF THE BUDGET, THE ORIGINAL PROMISE THAT SOCIAL SECURITY FUNDS WOULD BE PROTECTED FOR FUTURE RETIREES WOULD BE MET, AND THE REDUCTION IN THE PAYROLL TAX WOULD BE LESS IMPERATIVE.

AS A "BABY BOOM" LEGISLATOR, I WOULD LIKE TO REQUEST THAT YOUR COMMITTEE TAKE ANOTHER LOOK AT THE LONG-TERM SOLVENCY OF THE SOCIAL SECURITY SYSTEM. WHETHER SOCIAL SECURITY IS RETURNED TO PAY-AS-YOU-GO OR NOT, IT IS LIKELY THAT PAYMENT OF FUTURE RETIREES' BENEFITS WILL REQUIRE BURDENSOME INCREASES IN THE FICA TAX ON FUTURE WORKERS. IT MIGHT BE PRUDENT FOR CONGRESS TO ENACT BENEFIT ADJUSTMENTS THAT WOULD TAKE EFFECT 20-30 YEARS IN THE FUTURE. THIS WOULD SIGNAL TODAY'S WORKERS THAT THEY SHOULD MAKE THEIR RETIREMENT PLANS ACCORDINGLY, AND IT WOULD SIGNAL TOMORROW'S WORKERS THAT WE DO NOT INTEND TO RESORT TO HIGHER AND HIGHER FICA TAXES TO SUSTAIN BENEFITS.

I PLAN TO INTRODUCE SEVERAL BILLS IN THE NEAR FUTURE THAT WOULD ADDRESS SOME OF THESE CONCERNS.

AS WE HAVE HEARD MANY TIMES IN THE PAST MONTH, REDUCING THE PAYROLL TAX IS A DRAMATIC AND CONTROVERSIAL STEP. BUT I BELIEVE THE PROPOSAL MAY FINALLY BRING US TO OUR SENSES ABOUT THE DEFICIT. THERE ARE MANY OPTIONS AVAILABLE TO ACHIEVE DEFICIT REDUCTION. HOWEVER, UNLESS WE FACE THE DEFICIT HONESTLY, AMERICAN TAXPAYERS - BOTH NOW AND IN THE FUTURE - WILL BE THE REAL LOSERS.

childhood education for disadvantaged children age three to five is valuable and cost effective, yet limited federal funding permits only 20% of eligible children to take part. Many of our competitors seem to have a stronger commitment to early childhood education, and some of them have nearly universal pre-kindergarten enrollments. In France, 100% of four and five year olds attend school/educational day care, 90% of three year olds attend, and 36% of the two-year-olds. In Belgium, 96% of three- to six-year-olds are in school, and in the Netherlands, 98% of four- and five-year-olds.

Spending more money is not, of course, the only answer to the difficult problem of revitalizing primary and secondary education in the US. But the data presented here indicate that in education, as in every other service, we may "get what we pay for." Given the level of investment in our pre-primary, primary, and secondary schools, it is not surprising that we are slipping behind in comparative measures of performance as well.

## LEGISLATION TO RESCIND THE SOCIAL SECURITY [FICA] TAX

### HON. TIMOTHY J. PENNY

OF MINNESOTA

IN THE HOUSE OF REPRESENTATIVES

*Tuesday, January 23, 1990*

Mr. PENNY. Mr. Speaker, today I am introducing legislation to rescind the Social Security [FICA] tax increase that went into effect on January 1, 1990, and to further reduce the FICA tax in 1991 by 1.1 percent on both employees and employers. A similar proposal has been advanced in the other body by Senator DANIEL PATRICK MOYNIHAN.

Specifically, my bill will reduce the FICA tax to its 1989 level of 6.06 percent from the current level of 6.2 percent. In 1991, the FICA tax would be further reduced to 5.1 percent. The legislation would result in a $7 billion saving for Social Security taxpayers in 1990 and a $55 billion saving in 1991. The FICA tax levels proposed in my bill are based on the recommendations of Robert J. Myers, who was Social Security's chief actuary for 23 years, in testimony before Senator MOYNIHAN's Social Security Subcommittee last year.

This tax reduction will mean an additional $600 per-year to a couple with combined earnings at the Social Security taxable maximum ($54,300 in 1991). For the 74 percent of working Americans who pay more FICA taxes than Federal income taxes, this will be real tax cut. It will produce an immediate positive impact on the overall economy and should assist in creating new job opportunities.

My legislation will also put to an end the "great budget charade of the 1980's," namely: using Social Security tax receipts to fund the general operations of government, a purpose for which they were never intended. Enactment of this legislation will finally force the President and the Congress to focus on real deficit reduction while protecting future Social Security retirees.

I know this is a controversial and provocative proposal. However, dramatic action is necessary to force Congress and the administration to talk about how to set national priorities and balance the budget. With the actual deficit exposed we will be required to look at a combination of specific budget cuts and/or tax increases to bring us to our goal of a balanced budget. Second, it will once again stimulate discussion on the long-term solvency of the Social Security system, including the possible adjustment of benefits in the future for those in the Baby Boom generation. We want to guarantee their retirement benefits without imposing a huge tax increase on 21st century workers. In the near future, I plan to introduce additional reforms to address these concerns.

Reducing the payroll tax is a dramatic step, but one that may be necessary to bring us to our senses about the deficit. There are many options available to achieve this objective, but it is clear that we must act now.

H.R. – 3365

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

SECTION 1. REPEAL OF SCHEDULED INCREASE IN SOCIAL SECURITY TAXES, REDUCTION OF TAXES IN 1991.

(a) TAX ON EMPLOYEES.—Subsection (a) of section 3101 of the Internal Revenue Code of 1986 (relating to tax on employees) is amended by striking the last 2 items in the table and inserting the following:

"1988, 1989, or 1990 ..... 6.06 percent
"1991 or thereafter ..... 5.10 percent."

(b) TAX ON EMPLOYERS.—Subsection (a) of section 3111 of such Code (relating to tax on employers) is amended by striking the last 2 items in the table and inserting the following:

"1988, 1989, or 1990 ..... 6.06 percent
"1991 or thereafter ..... 5.10 percent."

(c) SELF-EMPLOYMENT TAX.—Subsection (a) of section 1401 of such Code (relating to self-employment tax) is amended by striking the last 2 items in the table and inserting the following:

"December 31, 1987–January 1, 1991 ..... 12.12
"December 31, 1990 ..... 10.20."

(d) TIER 1 RAILROAD RETIREMENT TAX ON EMPLOYEES.—Subsection (a) of section 3201 of such Code (relating to tier 1 railroad retirement tax on employees) is amended by striking the last 2 items in the table and inserting the following:

"1988, 1989, or 1990 ..... 7.51
"1991 or thereafter ..... 6.55."

(e) TIER 1 RAILROAD RETIREMENT TAX ON EMPLOYER REPRESENTATIVES.—Subsection (a) of section 3211 of such Code (relating to tier 1 railroad retirement tax on employee representatives) is amended by striking the last 2 items in the table and inserting the following:

"1988, 1989, or 1990 ..... 15.07
"1991 or thereafter ..... 13.10."

(f) TIER 1 RAILROAD RETIREMENT TAX ON EMPLOYERS.—Subsection (a) of section 3221 of such Code (relating to tier 1 railroad retirement tax on employers) is amended by striking the last 2 items in the table and inserting the following:

"1988, 1989, or 1990 ..... 7.51
"1991 or thereafter ..... 6.55."

(g) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to remuneration paid after December 31, 1989.

(2) SELF-EMPLOYMENT TAX.—The amendment made by subsection (c) shall apply to taxable years beginning after December 31, 1989.

Post-Bulletin

TUESDAY, JANUARY 23, 1990
POST-BULLETIN, ROCHESTER, MINN

# Penny wants FICA tax cut

By WENDY KOCH
Post-Bulletin Washington Bureau

WASHINGTON — First District Congressman Tim Penny is taking a high profile on one of the most controversial issues confronting Congress as it reconvenes today.

Penny will introduce in the House a proposal to reduce the Social Security payroll tax on workers and employers, which could save a couple up to $600 next year. The measure would eliminate the Social Security surplus, which is now being used to finance the federal deficit.

A similar proposal, unveiled last month by Sen. Patrick Moynihan, D-N.Y., has ignited a firestorm of debate. President Bush has branded it a "charade" aimed at getting him to raise income taxes or eventually reduce Social Security benefits.

Penny says the plan is aimed at truth in budgeting. He said lawmakers cannot keep using Social Security money to pay for a deficit they have failed to control. If taxpayers know their Social Security taxes are being abused, he said, "they won't like it."

## Congressman says Social Security surplus being abused by lawmakers

"I want people around here to be honest about the budget," he said. Penny, a member of a bipartisan budget task force, has crusaded for years to reduce the federal deficit.

Under his and Moynihan's plans, the Social Security tax increase that went into effect this month would be rolled back. Instead of the current 6.2 percent level, it would stay at the 1989 rate of 6.06 percent. In 1991, it would drop to 5.1 percent.

The lower rates would save taxpayers $7 billion this year and $55 billion next year. They would eliminate the Social Security surplus, which is supposed to pay for the retirement of baby boomers beginning 20 years from now.

Currently, the extra money is used to buy Treasury bonds and bills. The Treasury then uses the cash to cover the federal deficit. The government is still obligated to pay retirees the money, but it might have to borrow money in the future to do so, or raise taxes on the next generation.

"It just isn't fair," Penny said.

Lawmakers also use the surplus to mask the true deficit. The Gramm-Rudman law requires Congress to reduce the deficit every year. But Congress manages to do so only by counting the surplus as revenue.

For instance, last fiscal year the true deficit was $204 billion. But Congress reduced it to $152 billion by counting the surplus, which was $52 billion. Unless changes are made, the surplus is expected to surge to $236 billion by the year 2000, according to the Congressional Budget Office.

Penny said that if the surplus cannot be protected, it should be eliminated. Last year he introduced a proposal to prevent the surplus from being used to finance the deficit. He said he would be satisfied with either protecting or eliminating the extra money.

The lawmaker describes his newer plan as "just another way to raise the same issue." He said he merely wants to "force a debate" on how to honestly conquer the deficit.

Penny's proposal differs from Moynihan's only in that it does not require the Social Security, or FICA, tax to increase after the year 2000. Moynihan's plan includes a future increase to cover the retirement costs of baby boomers.

Moynihan, a longtime defender of senior citizens, argues that the baby boomers' retirement will not be truly secure until the government stops mortgaging the nation's economic future by running huge deficits.

He and Penny said the current system, adopted in 1983, of building up reserves to pay for the retirement of baby boomers has not worked because the money is being used to pay for the deficit.

Penny said low-income and moderate-income workers are indirectly paying a disproportionate share of taxes. The FICA tax only applies to the first $51,300 of wages.

As Congress begins its new session today, several proposals about the Social Security payroll tax are likely to surface.

STATEMENT OF

MARTHA MCSTEEN

PRESIDENT OF THE

NATIONAL COMMITTEE TO PRESERVE
SOCIAL SECURITY AND MEDICARE

PRESENTED TO THE

SELECT COMMITTEE ON AGING AND
THE SUBCOMMITTEE ON RETIREMENT INCOME
U.S. HOUSE OF REPRESENTATIVES

REGARDING

SOCIAL SECURITY FINANCING PROPOSALS

FEBRUARY 28, 1990

Mr. Chairman, my name is Martha McSteen. I am president of the National Committee to Preserve Social Security and Medicare, a grassroots senior advocacy organization dedicated to protecting the entitlements on which millions of older Americans rely. Before my association with the National Committee, I served 39 years with the Social Security Administration, the last three as acting commissioner.

Mr. Chairmen, National Committee members welcome the debate on Social Security...its financing...and its future. And we appreciate your holding this joint hearing on proposals to trim the Social Security payroll tax rate.

To be sure, these proposals have done the nation a favor by focusing national attention on the way the Social Security surplus is being used to disguise the true size of the budget deficit. Chairman Roybal, you tried to start this debate four years ago when you introduced your Fair and Complete Tax for Social Security legislation. At that time, no one was willing to listen. But this is a debate that is sorely needed...and a debate that is long overdue. The National Committee continues to believe that tax rates can be reduced and that future tax rates should be adjusted through an automatic tax rate stabilizer to keep Social Security on a pay-as-you-go financing plan.

Our members confirmed this position in a survey conducted two weeks ago by Cooper and Secrest Associates. A summary of the survey results is attached. As long as benefits are not threatened -- and our members don't think they would be -- they support reduced payroll taxes.

It is entirely consistent for the National Committee to oppose excessive Social Security payroll taxes as strongly as we have opposed budget-driven proposals to trim or tax Social Security benefits. Social Security trust funds

should not be a part of the budget. They did not create the imbalance in the budget. And they should not be part of the solution.

Removing Social Security trust funds from the budget calculations -- as some members of Congress have proposed -- is an essential step to maintain the integrity of the Social Security system. Our poll shows that National Committee members overwhelmingly believe that the Social Security surplus should be used exclusively for Social Security benefits. Stopping the use of Social Security surpluses to pay for current government expenses is so important to our members that they would accept a higher deficit or the sacrifices necessary to balance the budget exclusive of Social Security.

As I see it, there are only two ways to prevent Social Security funds from being used to pay for current government expenses. One way is to balance the budget without the help of trust funds. But given that we've had such a difficult time reducing the deficit even with the Gramm-Rudman-Hollings Act, balancing the budget exclusive of Social Security and still maintaining the current payroll tax rates would be a formidable task.

That leaves us with a second option -- eliminating the unneeded surplus. It's much like getting rid of the ice cream and doughnuts before you go on a diet. You remove the temptation...and force yourself to make tough decisions. By removing the surplus -- and eliminating the temptation -- the country would return to the pay-as-you-go financing system under which Social Security has been funded for most of its history.

Traditional pay-as-you-go financing provides a basis for stable financing of Social Security that is fair to both taxpayers and beneficiaries. Current financing methods are not providing the stability which has been promised because the trillion dollar reserve, eventually reaching $12 trillion,

is really hollow -- consisting solely of taxpayer obligations. But taxpayers are being told they are prefunding some future benefits with higher payroll taxes.

Consider this...how will beneficiaries react to the refusal to correct any inequities in Social Security...such as the retirement test...when Social Security is running up surpluses of more than $100 billion a year?

Regardless of how we plan to finance Social Security over a long period of time, one point is clear -- and that is, the cost will permanently increase when the baby boom generation begins to retire. Some even say the cost of a pay-as-you-go plan will be unaffordable. But Social Security experts like Alicia Munnell say the burden will be...in her words..."completely manageable." Dr. Munnell points out that even around 2020 when taxes have to rise, the increases will be of roughly the same magnitude as those experienced by workers over the 1968-to-1990 period.

National Committee members by a better than two-to-one margin believe that a pay-as-you-go plan makes more sense than current law.

While the National Committee believes that the large reserve is both unnecessary and even unwise, it is clear that a reserve of some fashion will be needed to cushion Social Security in the event of an economic downturn. Some recommend a reserve equal to a full year's benefit payments -- a figure that will be reached next year. Others say the reserve should be larger. The truth is...no one really knows how large the reserve should be. What is clear is that much discussion, debate and research is needed before a clear consensus will emerge on exactly how large the reserve should be.

More than three-quarters of National Committee members surveyed consider a full year's reserve just right or even too much. But how much will be just right in the future? One of the lessons from the 1977 and 1983 Social Security Amendments is that any one set of assumptions about the

future will be wrong in the short run. In 1977, the assumptions were too optimistic; in 1983, the assumptions were too pessimistic. Consequently, the National Committee believes that future tax rates should be adjusted using an "automatic tax rate stabilizer"...to insure the stability as well as the soundness of the trust fund. Such a stabilizer would remove tax increases and decreases from the political process and trigger automatic annual adjustments to the payroll tax rates to keep the reserves at mandated levels. This automatic stabilizer would insure that tax rates are as low as possible for workers and employers...yet high enough to reassure beneficiaries that the program is financially solid. The legislation that Chairman Roybal intoduced four years ago included an automatic tax rate stabilizer that Congress might want to consider now.

President Bush has said that tax rate reductions would threaten current benefits. On this point, National Committee members disagree -- and disagree strongly, by a more than two-to-one margin. They believe that a more realistic threat to cut or tax benefits comes from continuing to include Social Security in the budget process.

While for the most part, National Committee members would not benefit directly from payroll tax rate reductions, they nevertheless do not want to stand in the way of tax relief for their children and grandchildren. On the other hand, seniors do expect Congress to treat beneficiaries fairly and to stop claiming that improvements in Social Security are unaffordable. After all, current surpluses are not solely the result of tax rate increases. They also came from mutual sacrifices by workers and beneficiaries back in 1977 and 1983. Beneficiaries helped to put Social Security back on good financial footing back then by agreeing to several reductions in benefits. Now,

Congress has a chance to show its recognition of those sacrifices by giving serious consideration to some benefit improvements.

Of course, changes in Social Security do not take place in a vacuum. The fate of Social Security financing is closely linked to the fortunes of the economy. Many opponents of cutting the Social Security payroll tax believe that our country's economic future depends on increasing national savings and that the best place to generate the needed savings is with the Social Security surplus.

The National Committee supports the goal of increasing national savings. But this particular approach -- even if politically feasible -- has to be balanced against the regressive impact of the payroll tax on low-income workers and against the job creation disincentive on labor-intensive employers. Economists Gary and Aldona Robbins argue that a payroll tax rate cut from 6.2 percent to 5.1 percent could increase our gross national product by $346 billion, increase available capital by $162 billion and create 930,000 new jobs over the next 10 years.

Before concluding, Mr. Chairmen, I want to mention one other important issue related to Social Security that you care about a lot and that is the need to make Social Security an independent agency with a strong governing board. The cabinet secretaries who now serve as Social Security trustees -- especially the Secretary of Treasury as managing trustee -- are faced with an unresolveable conflict of interest. They must balance the needs of Social Security with the other legitimate needs of the nation, such as reducing the deficit. But in so doing, their decisions may not always represent the best interests of Social Security. For example, the Administration's opposition to reducing tax rates is based on its concern for the deficit...not what is best for Social Security. Social Security's trustees must insist on and stand up for

what's right for Social Security first...and not leave this burden of conscience to members of Congress alone. Under the current arrangement, it's too easy for Social Security's trustees to get caught up in political manipulation of the system. We both hope that an independent Social Security agency with a strong governing board is at least one thing that comes out of this debate.

The National Commission on Social Security Reform deserves our thanks for rescuing Social Security from the brink of bankruptcy back in 1983. While many have attributed long-term financing intentions to the National Commission, it did not systematically examine long-term financing issues or consciously recommend a long-term financing strategy. That would have been too much to ask back then because the ship was in danger of sinking.

Well, Mr. Chairmen, now that the ship has been saved, it is time to begin the debate about long-term financing issues and to come up with necessary strategies. We know that you and other conscientious members of Congress will give it your closest attention.

Thank you.

COOPER & SECREST ASSOCIATES, *Inc.*
228 South Washington Street
Suite 330
Alexandria, Virginia 22314
(703) 683-7990

POLLING UPDATE

TO: Interested Parties

FROM: Cooper & Secrest Associates

DATE: February 23, 1990

SUBJECT: Member Poll Results: National Committee to Preserve Social Security and Medicare

We present for your review and consideration the findings compiled from a comprehensive national membership survey of the National Committee to Preserve Social Security and Medicare.

Between February 17 and 18, 1990, Cooper & Secrest Associates conducted a comprehensive national survey of the attitudes of members of the National Committee to Preserve Social Security and Medicare. All told, 500 15-minute interviews were conducted with National Committee members ages 60 and over. The margin of error for this project is plus or minus 5%. The findings that emerge offer a clear insight into the emerging opinions of National Committee members.

As long as Social Security benefits are not threatened, National Committee members favor reducing Social Security payroll taxes rather than letting Social Security surpluses be used to meet current government expenses. Most members do not believe that a payroll tax reduction will threaten benefits and they think that a one year's reserve is adequate. Ideally, members would like to reserve Social Security surpluses exclusively for future Social Security benefits, even at great sacrifice required to balance the budget exclusive of Social Security. But if that is impossible -- and most members give low marks to current deficit reduction efforts -- National Committee members do not want Social Security to be in the budget calculations or used to meet current government expenses.

Social Security Surpluses Should be Used Exclusively for Social Security Benefits

* The majority of National Committee members (86%) want Social Security to be used exclusively for future Social Security benefits. The response is similar to the nationwide response to the same question included in a Times Mirror survey done by Gallup last year.

Member Poll Results, Page 2
National Committee to Preserve Social Security and Medicare

* Even when told the significant sacrifice required to balance the budget exclusive of the Social Security surplus, 42% of the members favor large tax increases and/or cuts in federal programs to balance the budget while 39% oppose these sacrifices. Before answering this question, respondents were told that Social Security surpluses cannot be reserved exclusively for Social Security "as long as the government's deficit is larger than the Social Security surplus."

* Assuming the government can balance the budget, National Committee members favor saving the Social Security surplus rather than reducing payroll taxes by a 65% to 25% margin. Responses were more evenly divided when members were asked whether they wanted to save the Social Security surplus (45%) or increase benefits (43%).

Social Security Surpluses Should Not be Used to Reduce the Deficit

* A majority (54%) rated the government's effort to reduce the deficit as "poor" and another third (31%) said it was "only fair."

* By a 53% to 22% margin, National Committee members prefer a higher deficit rather than letting Social Security be used to reduce the deficit. While a large percentage of members are not sure (43%), four out of five members with an opinion even prefer reducing Social Security taxes on workers rather than using Social Security to meet government expenses.

* Three-quarters (75%) of National Committee members, especially upper income members, want to take "Social Security out of the nation's budget calculations so that Social Security cannot be counted against the federal deficit" and more than half (55%) want a faster timetable than that proposed by President Bush.

National Committee Members Favor Reducing Social Security Payroll Taxes

* National Committee members were reminded of "recent proposals to cut Social Security payroll taxes by people who argue that the government is not saving the surpluses but using the money to pay other government bills. Senator Moynihan of New York calls this 'thievery'." By a 48% to 36% margin members agreed with the idea of cutting Social Security taxes on workers and members favored a payroll tax cut by more than four to one "if the Social Security payroll tax cut could be reduced without any reduction in Social Security benefits."

* Later National Committee members were presented with two options to finance Social Security in the long-term, "During the next thirty years, payroll taxes under current law will be higher than needed to pay benefits. Under an alternative approach, payroll taxes could be lower for the next thirty years and higher after that." By a 45% to 20% margin, National Committee members prefer the alternative of "lower taxes now, higher taxes later."

* More than half (58%) disagree with President Bush that "the proposal to cut Social Security payroll taxes and reduce the surplus is really intended to get him to cut Social Security benefits."

* These answers may be partially explained by the fact that 53% of National Committee members believe that Social Security is in excellent or good financial shape and that two-thirds of respondents believe that Social Security's financial shape has gotten better (26%) or stayed the same (41%) in the last five years. In fact, the Social Security reserve level at the end of 1990 is considered just right or even too much by 78% of National Committee members.

* Another factor in National Committee members' consideration may be the welfare of their grandchildren. While 74% of National Committee members believe that their children are at least as well off as they were at the same age, only 48% think their grandchildren will be as well off.

Member Poll Results, Page 4
National Committee to Preserve Social Security and Medicare

Views About the Impact of Payroll Tax Reduction on Other Taxes

* National Committee members disagree with President Bush that "the proposal to cut Social Security payroll taxes would lead to higher taxes elsewhere'" but only by a 45% to 39% margin. However, members with income over $30,000 agree with President Bush by a 49% to 43% margin.

* By similar margins National Committee members oppose a reduction in the capital gains (57% to 26%) and prefer a payroll tax cut to a capital gains tax cut (57% to 25%). Conservatives, Republicans, and upper income members are somewhat more sympathetic to a capital gains tax cut, but upper income members would prefer a payroll tax cut rather than a capital gains tax cut even more than lower income members.

COOPER & SECREST ASSOCIATES, INC.

February, 1990

Telephone Number_____ _____

Interviewer Name_____

Area
Northeast 28%
Southeast 17%
Midwest 22%
South Central 11%
West 22%

STUDY #9017 NCPSSM S.S.

Sample Point_____

CHECK QUOTA:
Male.....45.1
Female.....55.2

Interview dates Feb. 10-11

Hello, my name is_____ with Cooper & Secrest Associates, the national public opinion research company. May I speak with Mr./Mrs. (name on the list) please? (ONCE CORRECT PERSON IS ON THE LINE, REPEAT INTRODUCTION AND SAY:) We are conducting a national survey of public attitudes toward some important issues and I'd like to ask you a few questions so that your opinion will be counted.

Q1. First of all, what is your age, please? (READ CATEGORIES.)

Below age 50....71.1 (TERMINATE)
Age 50-59.....72.2 (TERMINATE)

Age 60-64.....24.3
Age 65-69.....32.4
Age 70-74.....21.5
Age 75-79.....14.6
Age 80 and over..97
ASK Q2.

Refused.....77.8 (TERMINATE)

Q2. Would you say that your children are better off, worse off, or just about the same economically as you were when you were their age?

Better off.....61..1
Worse off.....12..2
About the same...13..3
No children (VOL)10..4 (SKIP TO Q4).
Not sure.....4..5

Q3. Would you say that your grandchildren will be better off, worse off or just about the same economically when they get to be their parents' age?

Better off.....37.1
Worse off.....16.2
About the same.....11.3
No grandchildren (VOL)..5.4
Not sure.....31.5

Q4. How would you rate the federal government's effort when it comes to reducing the budget deficit -- excellent, good, only fair or poor?

Excellent.....2.1
Good.....5.2
Only fair.....31.3
Poor.....54.4
Not sure.....8.5

Q5. Now, how would you describe the financial status of the Social Security system? Is it in excellent financial shape, good financial shape, only fair shape, or poor shape?

Excellent shape...14.1
Good shape.....39.2
Only fair shape...24.3
Poor shape.....15.4
Not sure.....8.5

Q6. Over the past five years, has the financial security of the Social Security system gotten better, gotten worse, or stayed about the same?

Gotten better.....261
Gotten worse.....212
Stayed about the same.413
Not sure.....124

Q7. To the best of your knowledge, is the amount of money collected from payroll taxes for Social Security more than the amount the government pays out to people receiving Social Security, or is the amount collected from payroll taxes less than the amount paid out in benefits, or is the amount collected about equal to the amount paid?

More than government pays out.....30.1
Less than government pays out.....12.2
About the same as government pays out14.3
Not sure.....36.4

Q8. Are you familiar with the Social Security Trust Fund?

Yes.....63.1
No.....33.2
Not sure...4.3

Q9. As you may know, the federal government has a surplus in the amount of money collected for Social Security. Some people feel that the surplus money should be put aside and reserved exclusively for Social Security payments in the future. Others favor borrowing the surplus money to meet current government expenses and help reduce the federal budget deficit. Which view comes closer to your own -- using the surplus exclusively for future Social Security payments or using it to meet current government expenses and to help reduce the deficit?

Use exclusively for future S.S. payments56.1
Use to meet current government expenses..5.2
Not sure.....8.3

Q10. As long as the government's deficit is larger than the Social Security surplus, the Social Security surplus is not put aside and reserved exclusively for Social Security payments in the future, but is used to pay the current bills in the rest of the government. Balancing the budget would require an annual tax increase to about $1,000 per adult or across-the-board spending cuts of approximately twenty percent. Do you favor or oppose large tax increases and/or cuts in federal programs to balance the budget?

Favor.....42.1
Oppose.....38.2
Not sure.....19.3

Q11. Assuming the government cannot balance the budget, which do you favor: using the Social Security surplus to meet current government expenses or reducing Social Security taxes on workers?

Use S.S. to meet gov't expenses..11.1
Reduce S.S. taxes on workers.....46.2
Not sure.....43.3

Q12. Assuming the government can balance the budget, which do you favor: putting aside the Social Security surplus and reserving it exclusively for Social Security payments in the future or reducing Social Security taxes?

| | | |
|---|---|---|
| Saving Social Security surplus... | 65 | 1 |
| Reducing Social Security taxes... | 25 | 2 |
| Not sure... | 10 | 3 |

Q13. Assuming the government can balance the budget, which do you favor: putting aside the Social Security surplus and reserving it exclusively for Social Security payments in the future or increasing benefits?

| | | |
|---|---|---|
| Saving Social Security surplus... | 45 | 1 |
| Increasing benefits... | 43 | 2 |
| Not sure... | 12 | 3 |

Q14. What if the choice came down to using the Social Security surplus to reduce the deficit or having a higher deficit, which would you choose?

| | | |
|---|---|---|
| Use surplus to reduce deficit... | 22 | 1 |
| Have a higher deficit... | 53 | 2 |
| Not sure... | 25 | 3 |

Q15. Some people have proposed taking Social Security out of the nation's budget calculations so that the Social Security Trust Fund cannot be counted against the federal deficit? Do you favor or oppose taking Social Security out of the nation's budget calculations?

| | | |
|---|---|---|
| Favor... | 75 | 1 |
| Oppose... | 17 | 2 |
| Not sure... | 8 | 3 |

Q16. President Bush has proposed a timetable to take Social Security out of the budget beginning in 1993 and completely by 1996. Do you agree with the timetable of this proposal or should Social Security be taken out of the budget earlier?

| | | |
|---|---|---|
| Agree with Bush timetable... | 26 | 1 |
| S.S. out of budget earlier... | 55 | 2 |
| Not sure... | 19 | 3 |

Q17. You have heard about recent proposal to cut Social Security payroll taxes by people who argue that the government is not saving the surpluses, but using the money to pay other government bills. Senator Moynihan of New York calls this "thievery." Do you agree or disagree with the idea of cutting Social Security taxes on workers?

| | | |
|---|---|---|
| Agree... | 48 | 1 |
| Disagree... | 36 | 2 |
| Not sure... | 16 | 3 |

Q18. President Bush says the proposal to cut Social Security payroll taxes and reduce the surplus is really intended to get him to cut Social Security benefits? Do you strongly agree with him, somewhat agree with him, somewhat disagree, or strongly disagree?

| | | |
|---|---|---|
| Strongly agree... | 8 | 1 |
| Somewhat agree... | 11 | 2 |
| Somewhat disagree... | 20 | 3 |
| Strongly disagree... | 38 | 4 |
| Not sure... | 17 | 5 |

Q16. If the Social Security payroll tax could be reduced without any reduction in Social Security benefits, would you favor or oppose a payroll tax cut?

| | | |
|---|---|---|
| Favor... | 72 | 1 |
| Oppose... | 16 | 2 |
| Not sure... | 12 | 3 |

Q17. President Bush says that the proposal to cut Social Security payroll taxes would lead to higher taxes elsewhere. Do you strongly agree, somewhat agree, somewhat disagree, or strongly disagree with that?

| | | |
|---|---|---|
| Strongly agree... | 20 | 1 |
| Somewhat agree... | 19 | 2 |
| Somewhat disagree | 19 | 3 |
| Strongly disagree | 26 | 4 |
| Not sure... | 16 | 5 |

Q18. President Bush and others are proposing to reduce the capital gains tax, that is, the tax on income generated from the sale of stocks, bonds and real estate. Supporters of this capital gains tax reduction say it will encourage economic growth. Opponents say it is just a tax break for the rich, and bad policy. What do you think? Do you favor or oppose the reduction in the capital gains tax?

| | | |
|---|---|---|
| Favor... | 26 | 1 |
| Oppose... | 57 | 2 |
| Not sure... | 17 | 3 |

Q19. Presuming there were no impact on the deficit or on Social Security, which do you believe is more fair -- a capital gains tax cut or a payroll tax cut?

| | | |
|---|---|---|
| Capital gains tax cut... | 25 | 1 |
| Payroll tax cut... | 32 | 2 |
| Not sure... | 43 | 3 |

Q20. During the next thirty years, payroll taxes under current law will be higher than needed to pay benefits. During the following thirty years, payroll taxes will be lower than needed to pay benefits. Under an alternative approach, payroll taxes could be lower for the next thirty years and higher after that. In sixty years the payroll tax rate would be identical under either plan to pay benefits. Which do you prefer, higher than needed tax rates now and lower tax rates than needed later, or lower taxes now and higher tax rates later?

| | | |
|---|---|---|
| Higher taxes now, lower later. | 20 | 1 |
| Lower taxes now, higher later. | 45 | 2 |
| Not sure... | 35 | 3 |

Q21. This year Social Security will take in $320 billion and spend $250 billion. Social Security will end the year with total reserves of almost $250 billion -- a full year's reserves. Do you feel that this reserve is too much, too little, or about the right amount?

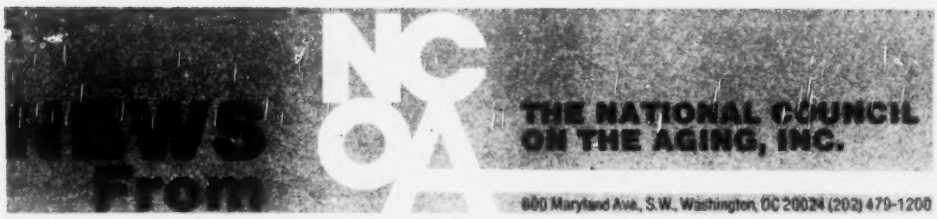
| | | |
|---|---|---|
| Too much... | 13 | 1 (SKIP TO F1). |
| Too little... | 8 | 2 (ASK Q22.) |
| Right amount... | 65 | 3 (SKIP TO F1). |
| Not sure... | 14 | 4 (SKIP TO F1). |

(ASK IF "TOO LITTLE" IN Q21.)

Q22. How much would you say is a sufficient reserve in the Social Security system, $375 billion -- equal to a year and half's reserve, $500 billion -- equal to a two year's reserve, $1 trillion -- equal to a four year's reserve, or more than $1 trillion?*

| | | |
|---|---|---|
| $375 billion/year and half reserve | 10 | 1 |
| $500 billion/two year reserve... | 15 | 2 |
| $1 trillion/four year reserve... | 24 | 3 |
| More than $1 trillion... | 22 | 4 |
| Not sure... | 29 | 5 |

* Base too small to be statistically reliable.




FOR IMMEDIATE RELEASE

CONTACT: Dan Schulder
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NATIONAL AGING GROUP URGES SOCIAL SECURITY DOLLARS NOT "MASK DEFICIT"; CALLS FOR SOCIAL SECURITY SAVINGS FOR BABY BOOMERS

Washington DC, February 28, 1990--The National Council on the Aging (NCOA) supports prompt Congressional action to end the use of Social Security surpluses to mask the true extent of the federal deficit.

At the same time, NCOA challenges proposals to cut back Social Security tax rates in the face of the needs of the nation's "baby boomers" facing retirement in the coming decades.

The statement will be released at a hearing of the House Select Committee on Aging.

NCOA President Daniel Thursz said that a cutback in payroll taxes would abort the planned increase in reserves designed to satisfy the retirement needs of the "baby boomers" retiring in the next century.

"Without a reserve buildup in the funds, workers in the middle of the next century will be liable for potentially onerous payroll taxes that may not be politically sustainable," Dr. Thursz said.

Thursz further expressed concern that--in addition to eroding confidence in the system--such a cutback would prevent "potential adjustments or transfers between and among trust funds to accommodate the possible future needs of Medicare, the disabled, or women."

Nevertheless, the reserves should be removed from Gramm-Rudman-Hollings deficit calculations as quickly as possible, with any revenue shortfall addressed by other means, including appropriate changes in the graduated income tax system, Thursz said. In NCOA's view, "the prompt removal of this fiscal smoke screen will clarify the true and troubling level of the deficit," Thursz concluded.

###

**NCOA STATEMENT ON PROPOSALS TO REDUCE SOCIAL SECURITY PAYROLL TAXES AND TO REMOVE SOCIAL SECURITY COMPLETELY OFF FEDERAL DEFICIT CALCULATIONS**

NCOA opposes the proposed cutback in Social Security payroll tax revenues as unwise and potentially dangerous. At the same time, NCOA supports proposals to end promptly the use of annual Social Security income surpluses to understate the true level of the federal deficit.

The National Council on the Aging has reviewed legislative proposals to cut Social Security payroll taxes and to adopt a limited model of "pay-as-you-go" funding for Social Security. These proposals would remove annual Social Security surpluses from Federal budget deficit calculations.

As a social insurance system that protects the American family, Social Security has worked well for a half century. To reduce resources available to this successful system is unwise.

Cutting 1.1% of the payroll tax for both employers and employees will result in OASDI trust fund reserves of less than 12 months. This cutback would abort the planned increase in reserves designed to accomodate the needs and expectations of the nation's "baby boomers" approaching retirement in the next century.

Without a reserve buildup in the funds, workers in the middle of the next century could face heavy payroll taxes. Sufficient reserves would facilitate inter-fund transfers and adjustments to accomodate future needs of Medicare, disabled persons and women beneficiaries. Should a buildup in reserves not take place, the net result could be a decline in confidence in the soundness of the system, especially for future beneficiaries.

While the prompt removal of this fiscal smoke screen will clarify the true and troubling level of the deficit, NCOA believes that the deficit should be treated through other responsible means including changes in a graduated income tax system. The impact of higher deficits could be softened by a stretch-out of the Gramm-Rudman-Hollings annual deficit targets.

NCOA acknowledges the historic work and foresight of the 1983 National Commission on Social Security Reform which, through bipartisan compromise on essential questions of equity and national savings, has strengthened Social Security for many decades to come.

NCOA recognizes the disproportionate burden on working persons of the payroll tax and calls for a reexamination of current tax policies in the face of the nation's needs. While the payroll tax is essentially regressive, NCOA notes that in terms of levels of protection against disability for younger workers and their dependents and the weighted benefits payments for persons with lower lifetime incomes, the Social Security system remains equitable, sound and progressive.

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March 21, 1990

The Honorable William J. Hughes
Chairman
Subcommittee on Retirement Income and Employment
Select Committee on Aging
United States House of Representatives
Washington, D.C. 20515-6362

Dear Mr. Chairman:

In connection with your Subcommittee's February 28, 1990 hearing on proposals to remove the Social Security trust fund from calculations of the federal deficit and return the fund to a pay-as-you-go system, I am writing to share with your Subcommittee the policy of the American Bar Association on the subject.

The ABA's House of Delegates at its February 1990 Midyear Meeting addressed this issue and passed a resolution opposing legislation which would cut significantly current Social Security tax rates and return the financing of Social Security to a "pay-as-you-go" system. The ABA also took the position that the trust fund should be removed from the Federal Government's operating budget, since the true Federal deficit is being masked by including the Social Security trust fund. The report of the ABA's Commission on Legal Problems of the Elderly that provided background to the House in adopting the ABA policy is also enclosed. The background report does not constitute ABA policy. Only our resolution is ABA policy.

The ABA has long been interested in the soundness and solvency of the Social Security system. The ABA, through its Commission on Legal Problems of the Elderly, has devoted a great deal of time over the years to advocating improvement of the Social Security and health care systems. It is the belief of the ABA and its Commission that nothing is more important to the elderly population of the country and to those who will retire in the future than a sound and solvent Social Security system in which they can have confidence.

Thank you for the opportunity to provide you with the ABA's position. The ABA would be pleased to present testimony should your Subcommittee conduct additional hearings on this issue. We ask that this letter be made a part of the February hearing record.

Sincerely,

Robert D Evans

Robert D. Evans

cc: Members, Subcommittee on Retirement Income and Employment

6523M

BACKGROUND INFORMATION

JOINT HEARING OF THE HOUSE SELECT COMMITTEE ON AGING AND THE SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT

"Returning Social Security to Pay-As-You-Go Financing: Impact on Benefits and the Federal Budget Deficit"
Wednesday, February 28, 1990
2322 Rayburn, 10:00 am

## Social Security Trust Funds

Social Security taxes, like all other Government revenues, are deposited in the U.S. Treasury. The taxes are accounted for separately through the posting of non-marketable securities to the Social Security and Hospital Insurance (HI) trust funds. Currently, $158 billion of Social Security collected taxes are 'posted' to the Trust Funds. These reserves are scheduled to continue to grow over the next twenty-five years with income far exceeding outgo until 2030, the peak of the baby boom retirement (see enclosed chart).

Although the Social Security program is considered "off-budget"; it cannot be subject to Gramm-Rudman budget cuts; the surpluses are included in the budget, like all other sources of revenue, to meet the Gramm-Rudman budget targets and finance the operation of the U.S. government. The continued use of the Social Security trust funds to help offset the deficit prompted various legislators to introduce proposals to discontinue or prevent this practice. (See chart on status of deficit with/without Social Security).

Due to revisions made in 1983, the Social Security OASDI (Old-Age, Survivors, Disability Insurance) tax increased this January from 6.06% of taxable earnings (up to a maximum $48,000 wage base) to 6.20% of taxable earnings (up to a maximum wage base of $51,300). Any earnings above that amount are not subject to the Social Security tax. The Hospital Insurance (HI) portion remained the same at 1.45 percent for a combined tax of 7.65 percent. During the 1980's, the OASDI-HI tax rose 25%, as income taxes were reduced. The Social Security tax is considered regressive because earnings are taxed at the same rate regardless of income, and taxable earnings are capped.

For more background and technical information see enclosed CRS Issue Brief "Social Security: Surplus Receipts Trigger New Financing Debate. (IB90033)

**Proposals:**

Senator **Moynihan** (D-NY) and Rep. Tim **Penny** (D-MN) introduced legislation (S. 2016 and H.R. 3085) which would repeal the January 1, 1990 Social Security tax increase and return Social Security to pay-as-you-go financing. The basic elements of the Moynihan/Penny proposal are:

-- The OASDI tax increase (from 6.06 to 6.2 percent) would be repealed. This would reduce the trust fund reserves by an expected $7 billion in 1990.

-- The OASDI payroll tax would be reduced to 5.1 percent in January 1991. According to SSA actuaries, this would return the system back to pay-as you-go financing. The expected decrease in Social Security revenue would be $55 billion in 1991.

-- In subsequent years, the OASDI trust fund would be kept at 100 percent of annual outlays, which is the amount recommended by the SSA actuaries. GAO recommends maintaining 100-150 percent of outlays (a one to one and one-half year additional surplus).

-- Currently, the total Social Security surplus is $158 billion. Relative to annual outgo, this surplus equals about nine months worth of benefit payments.

-- The OASDI payroll tax schedule would be revised as follows:

| Year | Tax Rate |
|---|---|
| 1990 | 6.06% |
| 1991-2011 | 5.10 |
| 2012-2014 | 5.60 |
| 2015-2019 | 6.20 |
| 2020-2024 | 7.00 |
| 2025-2044 | 7.70 |
| 2045-and on | 8.10 |

-- According to current law, no Social Security tax increases are scheduled to occur. The Congressional Budget Office and the General Accounting Office both maintain that no matter how Social Security is financed today, the government will have to pay the retirement benefits of future generations by either raising taxes or reducing spending in other federal programs.

**Administration Plan:**

-- This plan does not take effect until 1993. Extends Gramm-Rudman deficit target to zero

-- Establishes a new "Social Security Integrity and Debt Reduction Fund" which would equal the trust fund surplus and be phased in over three years beginning in 1993

-- Requires that the new fund use its receipts to retire the national debt

-- The Bush plan does not reduce the payroll tax and continues to build up reserves

**Porter Plan:**

-- Creates an Individual Social Security Retirement Account (ISSRA) for every worker

-- Refunds annual Social Security surplus to ISSRA's

-- Requires individuals to buy lifetime annuities upon retirement

-- Current beneficiaries receive 'as promised' benefit levels, future benefits are less certain for low-income workers

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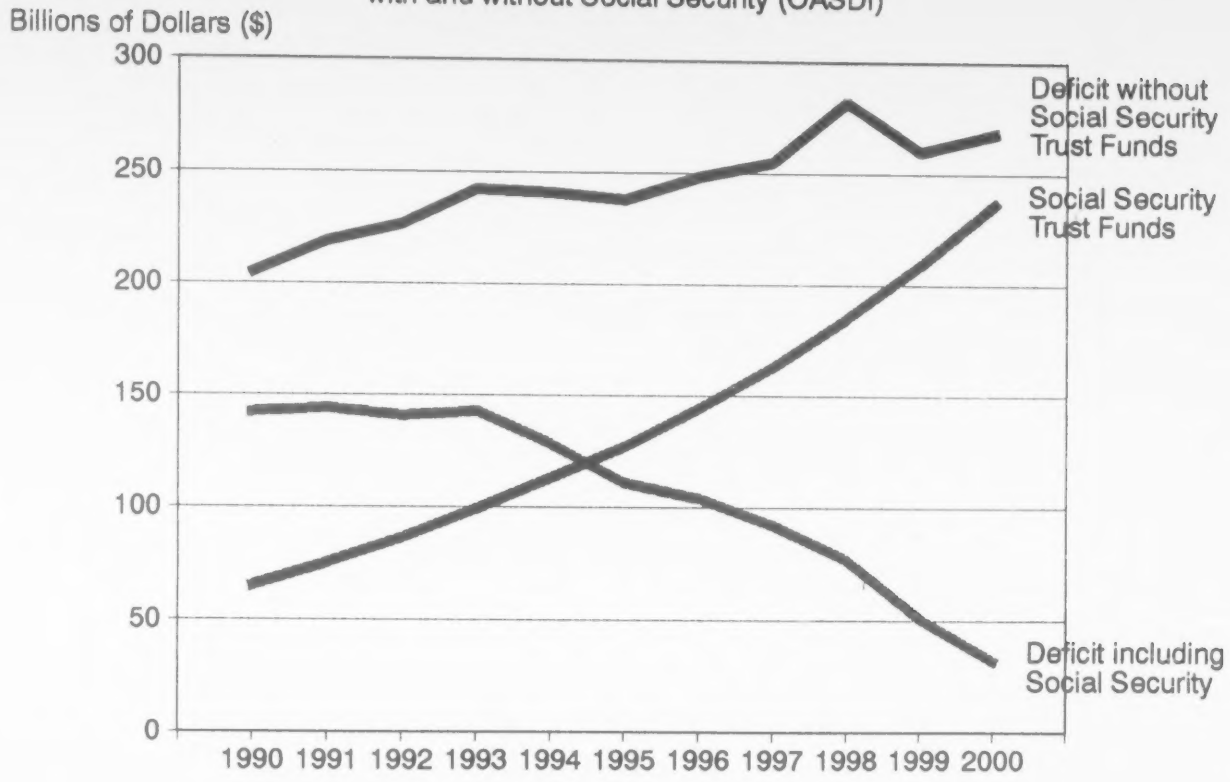
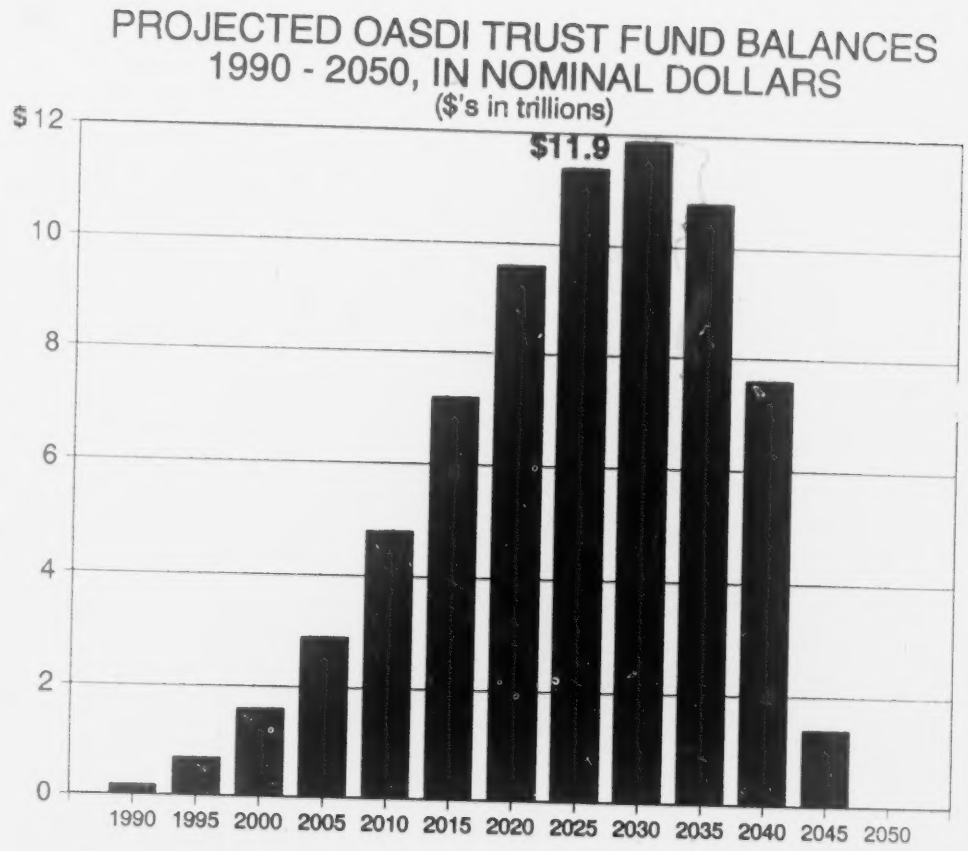
# FEDERAL BUDGET DEFICITS
## with and without Social Security (OASDI)




Source: Congressional Budget Office




Source: 1989 OASDI Trustees' report, Intermediate II-B Forecast.

# The Social Security payroll tax

| | 1989 | 1990 |
|---|---|---|
| Maximum taxable earnings | $48,000 | $51,300 |
| Tax rates for -- | | |
| Employee and employers each: | | |
| Total | 7.51 | 7.65 |
| OASDI | 6.06 | 6.20 |
| HI | 1.45 | 1.45 |
| Self-employed: | | |
| Total | 13.02 | 15.30 |
| OASDI | 10.51 | 12.40 |
| HI | 2.51 | 2.90 |

In FY 1989 the OASDI trust funds had:

- income of $284.9 billion, and
- outgo of $232.5 billion, for an
- annual increase in reserves of $52.4 billion.

Total reserves at the end of FY 89 were $156.7 billion

Selected Articles for the Hearing on February 28th
"Returning Social Security To Pay-As-You-Go Financing:
Impact On Benefits And The Federal Budget Deficit"
By
House Select Aging Full Committee
Subcommittee on Retirement Income and Employment

## INCOME SECURITY FOCUS/JULIE KOSTERLITZ

# Pay Tomorrow

It's hard to know what the rest of the nation makes of the explosive proposal by Sen. Daniel Patrick Moynihan, D-N.Y., to cut social security taxes, but inside Washington, even those who have no intention of supporting it are calling it a triumph for honesty in government. This is what is known as damning the proposal with not-so-faint praise.

Moynihan says the federal government is using a buildup in social security reserves to mask the size of the budget deficit. That's bad, the argument goes, because it misleads the public into believing that real progress is being made in cutting the deficit and falsely persuades it that this money is being saved up for the baby boomers' retirement. And, it's argued, this scheme uses the regressive payroll tax to finance wanton federal consumption.

The problem is, Democrats and Republicans alike have an interest in obscuring the cost of government because the public has made it clear it doesn't want to face up to the cost.

Moynihan's truth-in-spending bill worries conservatives and President Bush because they believe that if confronted with a deficit substantially larger than what is now advertised, they would be pressured to raise taxes, something they oppose philosophically and are pledged not to do.

Liberals are worried because they are afraid that with the social security surplus gone, a tax-shy public would resist raising the kind of money needed to meet the nation's large and growing public needs.

Among politicians of both stripes, there's a tacit acknowledgment that it's OK to raise taxes so long as people don't realize it. The payroll tax is the perfect tool for that job: Increases are set years before they go into effect, lessening the political backlash.

Moreover, polls show that the payroll tax is far more acceptable to the public than income taxes are. That's in part because—in theory, anyway—it goes for a specific program that is very popular. Leona Helmsley's conviction notwithstanding, the public thinks income taxes can be gamed but payroll taxes cannot. "We should take the buildup of reserves in social security as a benign force in American public life, a form of taxing this generation in ways that are more acceptable to it than other forms of taxation," Theodore R. Marmor, a professor of public management and political science at Yale University, said at a conference last year sponsored by the American Association of Retired Persons (AARP).

It may not be nice to fool the public about the size of the deficit, but consider the alternative. Aside from the shock therapy Moynihan is proposing, the other major option is to remove social security surpluses from deficit calculations and try to balance the budget without that money.

This, many economists say, would effectively free up more money for private investment, boost productivity and thus make it easier for tomorrow's workers to finance the baby boomers' retirement. Indeed, Moynihan proposed this option last year, to general apathy, and White House budget director Richard G. Darman is pushing a variant to counter Moynihan's new, more radical stance.

But if the nation truly wants to balance the budget and not merely mask it with social security surpluses, Northwestern University economist Robert Eisner noted at the AARP conference, it must raise taxes or cut spending. Neither approach, he argues, is politically feasible or economically desirable.

Even if raising taxes were politically salable (ask Walter F. Mondale what he thinks), it would mean less money for individuals to save or spend. It might free up money for business to invest, but if individuals have less to spend, where's the incentive? As Eisner put it, "If you decide not to buy a new Chrysler, what is Mr. Iacocca going to do? . . . Build new plants? Quite the opposite." Moreover, Eisner asked, why assume that money spent by the private sector would improve productivity more than public expenditures would? "The great bulk of investment that will provide for the future is public investment" in such fields as research, education, health and infrastructure, he said.

For those who think that major cuts in government spending are the way to go, consider that the two largest areas of expenditure, defense and medicare, already have been cut substantially in recent years.

The rest of the budget is comparatively small, and most of it goes to the poor in the form of entitlements. It's not an easy place to make cuts in good times. Now, with 31 million Americans lacking health insurance, 1 in 5 children born into poverty and an education system that experts say is producing workers who can't meet the next century's challenges, the clamor has built for more public spending in these areas.

Is it worth bleeding public programs dry in hope of stimulating greater private investment? Doing so raises questions of equity, argued Pat Ruggles, a senior research associate at the Urban Institute. "Productive private-market investment is pehaps most likely to be used for physical capital such as plants and equipment [that] are likely to increase incomes most for those who are already high-income earners or entrepreneurs," she told the AARP session. Public investments, by contrast, "may be more likely to go into things like education and infrastructure, which may benefit more lower-income families or those who live in disadvantaged regions."

That argument may offset concerns that financing government from a payroll tax hurts the poor. Moreover, federal policy makers have devised a way to offset the disproportionate impact of the payroll tax on the poor—the earned income tax credit. It was expanded in 1986 for that very purpose and stands a good chance of being expanded again this year.

Isn't it dishonest to pretend we're socking money away for the baby boomers' retirement when we're frittering it away?

Not really. Surplus or no surplus, Ruggles explained, when it comes time to pay for the baby boomers' retirement, the public will still have to do it in one of three ways: raising taxes, issuing new debt or cutting public spending.

There is, she said, "no money under the mattress," and "tomorrow's retirement obligation will still have to be met out of the resources that are available tomorrow." ☐

# ;ial Security's Coming Problem: Surpluses

By ROBERT J. MYERS

An examination of the recently leased 1986 Trustees Report on the ld-Age, Survivors, and Disability In- rance (OASDI) program, commonly ferred to as "Social Security," veals a coming financial problem.

It is not impending bankruptcy, as revailed in the early 1980s.

Rather, it is impending excessive and surpluses.

The nation's growing economy has roduced a balance in the OASDI Trust unds of $42 billion at the end of 1985. his is an increase of $9 billion over last ear, despite paying out $186 billion in enefits and paying $1.8 billion of the 982 loan of $12.4 billion from the lospital Insurance (Medicare) Trust 'und. Furthermore, OASDI was able o pay back the balance of that loan this ast January.

Under the immediate estimate in the Trustees Report, the OASDI Trust 'und increases significantly, reaching :186 billion by the end of 1990. This und balance—75 per cent of the next year's outgo — is very healthy. Thereafter, the fund grows even more, both in dollars and as to the fund ratio (balance in fund as percentage of annual outgo).

In 2015, the fund ratio increases to a peak of 526 per cent (somewhat more than five years' outgo), with a colossal fund balance of about $7 *trillion*! The balance then, however, decreases slowly until the fund is exhausted shortly before 2050.

Quite obviously, when the fund is exhausted, either additional financing or benefit reductions will be necessary to maintain the program's existence. The intermediate estimate indicates that, after 2050, an additional 2.5 per cent would have to be added to the combined employer–employee tax rate over that now scheduled, in order to finance the program.

But for now, the OASDI program is in excellent financial shape — certainly for the next 10 to 15 years and very likely over the long-range future. This outlook is based on the intermediate estimate which, in my opinion, is based on reasonable demographic and economic assumptions.

Yet it is this very health of OASDI which could lead to economic and fiscal problems in the 1990s and early years of the next century.

Such huge fund balances would result, by law, in the Trust Fund's buying up the vast majority (or even all) of the federal government's debt. Or, even worse, if all of that money became available to the General Fund of the Treasury, Congress might be tempted to make larger general expenditures than it would have otherwise. Either scenario would mean higher general taxes later when the Trust Fund investments are redeemed to meet the higher OASDI costs of the post-World War II baby-boom population reaching retirement age (in about 2015 and after).

Also, equally importantly, such large fund balances would likely result in pressure for large benefit liberalizations. This would mean very high— perhaps unsupportable — costs later when the baby-boomers reach retirement age. With greater benefits, payroll taxes would increase much more than just 2.5 per cent, as mentioned earlier.

To solve this problem, on the basis of the intermediate estimate, I would recommend reducing the scheduled OASDI tax rates during 1990 to 2015. The best way of doing this would be with an automatic-adjustment procedure, so as to maintain a fund ratio of about 50 to 60 per cent at all times. Of course, this would mean slightly higher tax rates than are now scheduled, beginning in 2020. Yet, such lower OASDI tax rates could partially offset increases in the hospital insurance (Medicare) tax rate which will apparently be necessary in about 10 years.

It's ironic to describe Social Security Trust Fund surpluses as a potential problem, but a long-term examination of the consequences of "borrowing" those surpluses shows that it is a temptation to be resisted. □

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*Mr. Myers served as the chief actuary of the Social Security Administration from 1947-70, deputy commissioner of the Social Security Administration from 1981-82 and executive director of the National Commission on Social Security Reform from 1982-83. This article is provided as a service of the National Forum Foundation's Editorial Distribution Service.*

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1/23/90 p.A25

THE WASHINGTON POST

# No, Senator, No

*Robert M. Ball*

## Moynihan's Social Security Bombshell

With his proposal to cut $55 billion in Social Security taxes in 1991 alone—more later—Sen. Daniel Patrick Moynihan has turned the long-smoldering dispute over reserve financing for Social Security vs. pay-as-you-go into the hottest argument of the day. He has weighed in on the side of pay-as-you-go, and his views will certainly be listened to with great respect; for over a decade he has been Social Security's leading champion in the Senate.

But is he right? On the matter of pay-as-you-go, my answer is, "Maybe, later on." But on the question of a Social Security tax cut this year or next, it is "Absolutely not." Here's why:

*1. The old-age, survivors and disability insurance (OASDI) reserve is not yet at a safe level for a pay-as-you-go plan.*

Even if we adopt pay-as-you-go, for safety's sake we should not reduce money going into OASDI just yet. In spite of all the talk about a huge reserve accumulating in the trust funds, the buildup lies mostly in the future. The reserves today have not yet reached a contingency level for a pay-as-you-go plan that most experts consider sufficient to protect fully against unexpected adverse economic developments, such as the back-to-back recessions of the late 1970s and early 1980s. Opinions vary, but the majority believe that a fully safe reserve ratio is in the range of 100 to 150 percent of the next year's payments. Currently the ratio is 75 percent.

Given the wrenching experience the country went through with two Social Security financial crises, one in the mid-1970s and one in the early 1980s, we ought to make certain that the contingency reserve provides a substantial cushion. I would favor keeping the reserve at a ratio of 150 percent. This level will not be reached until sometime between 1993 and 1995, depending on economic performance.

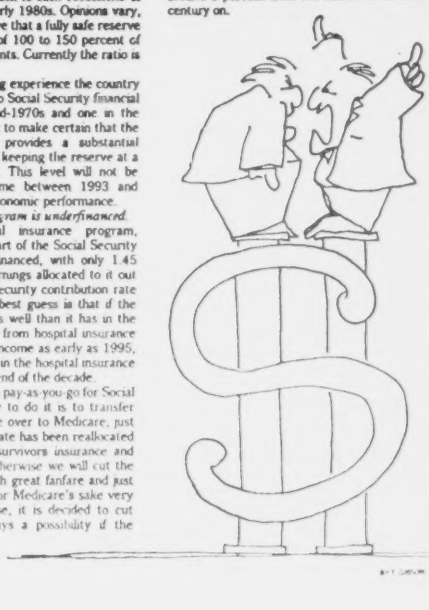
*2. The Medicare program is underfinanced.*

Medicare's hospital insurance program, which is paid for by part of the Social Security tax, is clearly underfinanced, with only 1.45 percent of covered earnings allocated to it out of the overall Social Security contribution rate of 7.65 percent. The best guess is that if the economy performs less well than it has in the recent past, payments from hospital insurance could start to exceed income as early as 1995, with all the bonds held in the hospital insurance fund liquidated by the end of the decade.

If we decide to adopt pay-as-you-go for Social Security, the safe way to do it is to transfer part of the OASDI rate over to Medicare, just as in the past the tax rate has been reallocated between old-age and survivors insurance and disability insurance. Otherwise we will cut the combined rate now with great fanfare and just have to raise it again for Medicare's sake very soon—unless, of course, it is decided to cut benefits. That is always a possibility if the programs get close to the financial cliff, as OASDI did in 1982. That financing crisis was resolved by benefit cuts in the 1983 amendments along with tax increases. The best protection for benefit levels in both OASDI and Medicare is adequate financing.

A good pay-as-you-go plan would be to wait until 1995, when an adequate contingency reserve is ensured, and then transfer from OASDI to Medicare the part of the OASDI rate now being proposed as a cut. Medicare would then be fully financed for the next 25 years and would end the period with a reasonable contingency reserve. Given the high degree of uncertainty about health care arrangements beyond 25 years, that would seem to be long enough to provide for Medicare financing.

A pay-as-you go plan would, of course, call for lower taxes now than a reserve plan, and higher taxes later. Without taking into account the clear need to increase Medicare rates during the period, the OASDI rates could be lower than the present 6.2 percent for 25 years, but then would have to rise well above that level by 2020. Under present law or pay-as-you-go, the rate will have to rise to around 8 percent from the middle of the next century on.



*3. Dropping the other shoe. What happens after a Social Security tax cut?*

Middle-income workers better not start spending the money—up to $600—being promised from a Social Security tax cut. To avoid increases in the deficit, a Social Security tax cut could would most likely be followed by increases in general taxes large enough to make up for both the employee rate reduction *and* the employer reduction. With deficits as high as they are, and with many unmet needs that only government can meet, it is unrealistic to think that one source of government revenue can be cut without another being raised.

*4. The longer-range issue—reserve financing vs. pay-as-you go.*

What about the longer-range issue of returning Social Security funding to pay-as-you-go? Here I say, "Maybe." The answer depends largely on whether a fund buildup would be handled so as to increase national saving or whether government borrowing from the fund would just substitute for general taxes or pay for the current expenditures of new or bigger programs.

Since the retirees of the future have to be supported out of the goods and services produced in the future, the only present actions that can help meet their needs are those that improve our capacity to produce. If the buildup of reserves results in a greater surplus in the total accounts of the government, then the Social Security reserves increase national saving and the capacity to produce goods and service.

On the other hand, if a surplus merely substitutes for higher general taxes or supports a greater level of expenditures, the Social Security buildup does not contribute to economic growth, and paying Social Security claims will be as much of a burden as under pay-as-you-go.

A Social Security buildup that increases our capacity to produce is theoretically possible but not easy to accomplish. The political system has to exercise enough restraint to finance programs other than Social Security without relying on borrowing from the trust funds. In spite of his past support for accumulating reserves, Sen. Moynihan has evidently become discouraged about reserve financing, and believes now that a buildup in the funds would simply hold down general taxes. If he is correct that we do not have the discipline to keep from borrowing Social Security funds to pay for the increases in the current operating expenses of government, then once the OASDI funds reach an adequate contingency level, we should stop the buildup and shift part of the tax rate to Medicare.

*The writer was Social Security commissioner from 1962 to 1973 and served as a Democratic representative on the National Commission on Social Security Reform in 1982-83.*

New York Times 1/24/90 p.A22

# How to Pay for Social Security

*I thought I understood what Senator Moynihan had in mind with his proposal to cut the Social Security payroll tax. He wants to stop using a tax that bears hardest on the poor to reduce the Federal deficit. That sure sounds nice. But if we reduce the payroll tax, won't benefits be threatened for people who retire in the future?*

No. Regardless of what people say about creating a big fund to cover the baby boomers, Social Security surpluses do not pay future retirees. Future taxpayers do, tax cut or no tax cut.

Right now, payroll taxes are high enough to generate large surpluses. These surpluses are lent to the Treasury. When the expected bulge in retirements occurs around 2020, the Treasury will have to pay back the Social Security Administration. How? With money from taxpayers.

Under the Moynihan plan, no surpluses will accumulate. Every year, the Treasury will have to turn over the necessary cash to the Social Security Administration. How? With money from taxpayers. Either way, future taxpayers pay the bill.

*In other words, the Moynihan tax cut would be harmless?*

Not really. Future taxpayers will pay, either way. But how much pain that causes them depends on how much the economy grows between now and then. Future taxpayers won't mind the tax burden if they feel well-off. The best way to guarantee that is for the nation to invest in education and capital equipment.

The big danger of the Moynihan tax-cut proposal is that it threatens such investment. Tax cuts drive up the deficit, siphoning private savings away from productive investment. The economy could shrivel, making future tax burdens unbearable.

*O.K., tax cuts harm the economy. But isn't Senator Moynihan right about the unfairness? Isn't there some way to help the majority of Americans who now pay more in payroll taxes than in income taxes?*

Yes. The flat-rate payroll tax that everybody pays up to $51,300 in earnings is a vestige of a powerful myth. Many people still think Social Security is an insurance system and that people only get back what they paid in. But in reality, most beneficiaries collect much more.

If Congress acts on the basis of that reality, it could readily fashion a tax system that spreads burdens fairly. The top marginal rate is now 28 percent. By raising it just a fraction of a percentage point, Mr. Moynihan could have his Social Security tax cut without worsening the deficit. Another remedy would be to make the payroll tax progressive, too.

*Then why didn't he propose something like that?*

Probably because he wants to make Congress face up to the hard choices. The worst outcome of all would be for Congress to pass the payroll tax cut and also pass the President's pernicious, sweeping cut in the tax on capital gains. That would mean an even bigger deficit and more pain for the next generation.

A better outcome would be for Congress to redistribute unfair tax burdens away from the poor without raising the deficit. But the best outcome of all would be to protect lower-income people now and also reduce the deficit. That would insure higher incomes when the Social Security bills come due. If that happens, Senator Moynihan's "hand grenade" will have done enormous good.

New York Times 1/18/90 p.A27

# Moynihan's Right, but. . .

By Henry J. Aaron
and Charles L. Schultze

WASHINGTON

Senator Daniel Patrick Moynihan recently advanced a proposal to reduce Social Security payroll taxes by $55 billion in 1991 and corresponding amounts in later years, thereby moving the Social Security system closer to pay-as-you-go financing. Such a change of policy, however, would damage the economy. Congress should reject this proposal.

Senator Moynihan, Democrat of New York, has raised a serious issue — the fact that large additions to Social Security reserves, financed by the payroll tax, are now masking the true size of the Federal budget deficit. He is justifiably angry that a regressive tax on wages is being used increasingly to pay for ordinary operations of the Government.

Such a tax is defensible if the additions to Social Security reserves are used to increase national saving and productive capacity, thereby helping future generations shoulder the costs of providing retirement benefits for the growing number of retirees.

But the Government is not using the proceeds of the payroll tax that way. It is now borrowing the additions to Social Security reserves to pay for the current operations of the Government. Exclusive of Social Security, the Federal Government budget deficit is huge and is projected to rise in the future.

We can well understand Senator Moynihan's frustration with this budgetary hoax, and perhaps his proposal is merely a tactical device to focus the public's attention on this outrage. But if enacted, the proposal would do serious harm to the economy.

. . . Social Security tax cuts are risky.

The immediate effect of the $55 billion cut in payroll taxes for 1991 that Senator Moynihan proposes would be to worsen the Federal deficit by an equivalent amount. To offset the potentially inflationary effects of an enlarged budget deficit, the Federal Reserve would have to raise interest rates, penalizing investment generally and long-term investments particularly. The higher budget deficit and increased interest rates would force the U.S. either to reduce investment at home or to increase borrowing from abroad. In either case, the already slow growth in American living standards would be further eroded. In short, cutting payroll taxes (or any other major tax cut) is the opposite of what is needed under current economic and budgetary conditions.

Although Senator Moynihan did not suggest it, the payroll tax cut could be made revenue neutral if it were linked to offsetting increases in income or excise taxes. Such a proposal would not add to the deficit. But it would wreck whatever chance now exists of successfully reducing the deficit through a compromise package of expenditure cuts and tax increases. If Congress were to use an income tax increase to offset the revenue loss from a payroll tax cut, it would become even harder than it now is to fashion a centrist political compromise that would combine spending cuts with income tax increases.

Simply cutting payroll taxes should be put off-limits because a payroll tax cut would worsen the budget deficit and thereby reduce still further the nation's already abysmally low saving rate. And combining such cuts with increases in other taxes is premature as long as any hope survives of fashioning a deficit reduction compromise. The best hope is that Senator Moynihan's proposal will provoke a review of the nation's currently absurd budgetary proposals. The worst fear is that it might actually be enacted. □

*Henry J. Aaron and Charles L. Schultze are senior fellows at the Brookings Institution.*

Washington Post 1/17/90 p.A19

# 3 Experts Offer a Different View On Effect of Social Security Taxes

## *Lower-Income Contributors Are Said to Gain More in the End*

By Spencer Rich
Washington Post Staff Writer

When Sen. Daniel Patrick Moynihan (D-N.Y.) launched his proposal to cut Social Security taxes, he stressed repeatedly that the Social Security tax is "regressive," falling most heavily on low-income and middle-income Americans.

As evidence, he cited figures showing that of all taxpayers who pay Social Security, 74 percent pay more in Social Security than they do in income tax.

The view that Social Security taxes are regressive, in contrast to income taxes, is commonly accepted by many economists and policymakers.

But there is a different way to view the tax, according to three Social Security experts who have long worked on the problems of the system: Henry Aaron, an economist with the Brookings Institution; Robert Ball, former Social Security commissioner; and Robert J. Myers, former Social Security chief actuary.

Over a lifetime, they said, the benefit formula guarantees that low-income taxpayers get higher benefits in proportion to the amount of Social Security they pay than do high-income taxpayers.

Viewed as a whole, the system has a progressive character that rewards the poor most for their contributions. "Benefits are very heavily weighted in favor of low-income people," Ball said.

"In my opinion," Myers said, "it's unfair to say that the Social Security tax is regressive. That only looks at part of the picture. If you look at the entire picture—benefits and taxes—the system is definitely progressive."

Social Security officials also noted that the striking statistic that 74 percent of those paying Social Security taxes find them higher than their income taxes is true only if the employer's contribution is included. Counting only what the worker loses directly in the payroll deduction drops the figures to 29 percent.

The case for claiming that Social Security is regressive—what Aaron calls the "one-year slice view"—usually includes these main points:

SEN. DANIEL MOYNIHAN
... would cut Social Security taxes

- Unlike the income tax, the Social Security tax is imposed at a flat rate, now 7.65 percent, on taxable wages. Whether a person makes $3,000 in wages or $30,000 or more, the rate stays 7.65 percent. The income tax rate, on the other hand, goes up progressvely as income rises.
- The Social Security tax is imposed only on the first $51,300 of wages. Therefore, the amount paid rises in proportion to income, but only up to $51,300 in wages. At that salary, the tax is $3,924.45. As a result, someone earning up to $51,300 a year pays 7.65 of total wages, but a person earning $100,000 still would pay only $3,924.45 this year, or 3.9 percent of wages, and someone with income of $1 million would pay only 0.39 percent.
- The Social Security tax is imposed on wages only, so if a worker has tens of thousands of dollars in non-wage income it escapes the Social Security tax. The income tax, in contrast, is imposed on interest, dividends, rents received and pensions, as well as wages.

The contrary view, that the system could be called progressive when benefits and taxes are considered, is illustrated in actuarial calculations by Myers and actuary Bruce Schobel.

They computed that a single man who had earned the average wage throughout his career, retired at 65 in the year 2025 and lived to the expected age, would receive benefits equal to 192 percent of what he had contributed in Social Security taxes over his lifetime plus interest. (These figures take inflation into account but do not include the employer Social Security tax contribution for the worker.)

By contrast, one who over his lifetime earned the maximum wage subject to the Social Security tax would receive benefits equal to 116 percent of what he had contributed.

Orlo Nichols of the Social Security Administration provides another illustration from a slightly different perspective.

He computed that a 65-year-old low-earning worker retiring in the year 2000 will get a monthly benefit equal to 58 percent of his normal monthly wages just before retirement that are subject to the Social Security tax.

An average-earning worker will get a benefit equal to about 43 percent and a high-earning worker about 26 percent of recent earnings subject to the Social Security tax.

Ball also emphasized that low-income families with children get a special income subsidy from the government called the earned income tax credit that was designed by former senator Russell B. Long (D-La.) specifically to compensate such families for the Social Security tax they pay. Long called it a "Social Security offset."

Last year the credit went to 9.8 million working poor and was $910 at wages of $6,500—more than the Social Security tax a family at that wage would have paid.

To Social Security Commissioner Gwendolyn S. King, it is clear that the Social Security tax should not be viewed in isolation but as part of a contributory system. "These are indeed contributions to Social Security that have paid benefits every month for the past 50 years," she said, "and it is a good deal."

Los Angeles Times
1/25/90 p.A19

# Social Security Surplus Raises Questions

■ **Payroll taxes:** A plan to cut reserves causes concern over the system's future. Here is a look at proposed changes and what they might mean.

By TOM REDBURN
TIMES STAFF WRITER

WASHINGTON—Nothing the federal government does touches Americans like Social Security. For most of the 40-million elderly and disabled Americans who receive benefits, Social Security is all that stands between them and destitution—making the system a sacred totem of U.S. political life.

And more than 110 million people, or nearly every person in the nation who works, pay taxes to support the system. Indeed, nearly one-third pay more in Social Security taxes than they do in income taxes. When the employer's matching share of the Social Security tax is counted, nearly three-fourths of Americans contribute more in Social Security taxes than in income taxes.

But now Social Security is embroiled in a new controversy: a proposal by Sen. Daniel Patrick Moynihan (D-N.Y.) to cut the payroll tax in order to eliminate a burgeoning surplus—a surplus created by tax rates approved only a few years ago to assure the system's future soundness. Although Moynihan's proposal was made as part of a complex political maneuver over the federal deficit, it has stirred alarm and uncertainty about Social Security itself.

"The public is confused and misinformed," says Henry Aaron, a Brookings Institution economist. "That goes for the politicians, too."

There are few clear-cut answers in the emerging debate over Social Security's growing reserves and how to deal with its temporary embarrassment of riches. Almost everyone has an ax to grind.

In an attempt to sort out the confusion, here are answers for a number of important questions about the current controversy swirling around Social Security.

**Question:** What happens to the money I pay in Social Security taxes?

**Answer:** Most of it is used to pay the benefits of current retirees. There is no individual account set aside for your contributions that allows them to build steadily for your retirement.

By law, nearly all employees are required this year to pay into the system at a rate of 7.65% on their earnings up to $51,300. Of that, 1.45% finances the Medicare program. The other 6.2% goes toward the Social Security program. The employee's tax is matched by employers, and self-employed individuals are required to pay the full amount themselves. Only the first $51,300 will be taxed this year, an amount that grows each year with inflation.

Last year, workers and employers paid more than $263 billion in Social Security payroll taxes to the federal government, roughly one-quarter of the government's total revenues. After paying benefits, the Social Security system had about $36 billion left over.

Q: So what happens to the cash that is not used to pay benefits?

A: The Social Security trust fund hands the money over to the Treasury in return for special government bonds. These are like IOUs from one part of the government to another. The Treasury has promised to pay back the money, with interest, in the future.

In the meantime, the Treasury uses the cash it receives from Social Security to help pay for all the other normal operations of the government, such as buying weapons, paying salaries, building sewers and operating national parks. The cash from Social Security reduces the amount of money the Treasury must borrow from private investors to cover the government's massive deficit.

Q: But if the rest of the budget is in deficit, isn't it "thievery," as Moynihan says, to use the Social Security surpluses to mask the size of the deficit?

A: A lot of people think so, but there is nothing inherently fraudulent about the practice. Social Security trust fund surpluses provide real deficit reduction. Without them, the government would have to borrow that much more to cover the deficit.

Nonetheless, many officials complain that it is wrong to rely on Social Security tax reserves to help pay for the current operations of the government. Particularly disturbing to some is that Social Security taxes hit low-income workers harder, taking a bigger chunk of their earnings, than those who earn more than the $51,300 ceiling.

Moynihan and some other politicians believe that if the government had to report the size of the deficit without the Social Security surplus, it would force action on proposals to narrow the budget gap by cutting spending or raising other taxes.

Q: So we should take Social Security "off budget?"

A: Paradoxically, that might make the situation even worse. Taking the surplus out of the calculation of the federal deficit would reveal $200-billion deficits in the rest of the budget. Faced with such large deficits, many analysts believe Congress would be paralyzed and would simply throw up its hands at the difficulty of ever closing such a wide gap.

Moreover, if Social Security were no longer subject to the discipline of deficit reduction, that would not only exempt the huge retirement program from a broad deficit accord, but it could also allow politicians to tap the "surplus" funds to satisfy demands for expanded benefits.

Q: Can't we do anything to save the Social Security surplus for the future?

A: Not directly. Even if the government were operating an overall surplus, the money would be "saved" in exactly the way it is today—invested in Treasury securities. There is no safer place to put it.

**Q:** What's wrong with investing the Social Security surplus in Treasury bonds?

**A:** Probably nothing, so long as the government collects enough tax revenue in future years to pay back the Social Security fund. And that depends on the future health of the U.S. economy as a whole. The most important thing the government can do is to follow policies that foster economic growth.

**Q:** If nothing changes, how big will the Social Security surplus get?

**A:** The yearly excess of income over outlays is expected to peak at about $160 billion in 2009. By 2018, when Social Security will again start spending more than it takes in from taxes, the annual surpluses are estimated to add up to $3 trillion. That money will be earning interest, and at its peak, the Social Security system should have a cumulative surplus worth up to $12 trillion.

But it is only the $3 trillion in actual extra cash that will be available to help offset deficits elsewhere or to reduce some debt. The interest earnings of $9 trillion in Treasury IOUs in the Social Security trust fund really represent nothing other than an intragovernmental accounting transaction—a promise by the Treasury to tax or borrow enough in the future to make good on its obligations.

**Q:** If Social Security doesn't need the money, why are the surpluses so large and growing?

**A:** For most of its history, Social Security has operated on a pay-as-you-go basis, attempting to take in roughly the same amount in revenues each year that it pays out in benefits, with a little left over in case the economy turns sour.

But after the back-to-back recessions of the early 1980s, the Social Security system was in terrible shape. So Congress approved a plan that raised Social Security taxes and cut back on future benefits.

Taxes were pegged at a rate that was designed to cover current benefits and to begin accumulating some savings for use when the baby boom generation begins retiring in 2011. The baby boomers will put such a burden on the Social Security system that the $12-trillion surplus will be exhausted, according to reasonable economic projections, in about 2050.

**Q:** What is Sen. Moynihan's solution?

**A:** It adds another twist to the debate. Moynihan proposed to roll back the Social Security tax rate to 5.1% in 1991. (He would leave the Medicare tax rate alone.) He did so chiefly because he is angry that the Republicans who have controlled the White House for a decade have refused to go along with higher federal taxes as part of a deficit reduction package. In hopes of forcing the issue, he wants to spread the alarm that the government is relying more and more on regressive Social Security taxes to finance its operations.

Moynihan wants to shift more of the burden of taxation to income taxes instead of payroll taxes. He and many other Democrats do not think it is fair that a wealthy taxpayer pays only a 28% income tax and no additional Social Security tax on each additional dollar of income, while someone with a middle income faces an effective tax rate of at least 35%.

**Q:** If the Moynihan proposal becomes law, will that reduce the chances that Social Security benefits will still be available when the baby boomers retire?

**A:** Not necessarily, but it could. Returning Social Security to a pay-as-you-go basis would mean that taxes could be cut to the level Moynihan recommends for about 25 years. Some people think that would be a good idea because, otherwise, Congress would spend the Social Security reserves for other purposes.

But in future years, when fewer workers will be supporting more retirees, the tax rate would have to jump sharply for most of the rest of the 21st Century in order to maintain benefits.

That could create an environment for huge political battles between harder-pressed workers and a large cohort of retirees over whether taxes should be raised or benefits cut. That's one reason that many economists think it is a better idea to build up reserves as the best way to deal with the demographic bulge and America's low savings rate.

**Q:** What would be the effect of turning Social Security into a private pension system, as proposed by Rep. John Porter (R-Ill.)?

**A:** Porter's proposal, which President Bush says should be considered as an alternative to the Moynihan plan, would allow each worker to contribute Social Security taxes directly to an individual account and control his or her own funds. It offers the advantage that funds could be invested in vehicles other than Treasury bonds. More than that, the government could not alter an individual's benefits by future policy changes. But unlike today's system, in which lower-income workers receive more benefits in proportion to their contributions than higher-income employees do, Porter's plan would eventually do away with the progressive features that have helped lift millions of the elderly out of poverty.

Order Code IB90033

# CRS Issue Brief

Major Planning Issue

## Social Security: Surplus Receipts Trigger New Financing Debate

Updated February 13, 1990

by
David Koitz and Geoffrey Kollmann
Education and Public Welfare Division

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# Social Security: Surplus Receipts Trigger New Financing Debate

## SUMMARY

Currently social security taxes are greater than social security expenditures. This difference is expected to grow larger over the next two decades. It would then decline, and sometime around 2015-20 the program's expenditures would begin to outrun its tax receipts as the post-World War II baby boomers enter retirement.

The social security tax rate (excluding a portion used for Medicare), paid both by employee and employer, rose from 6.06% in 1989 to a permanent rate of 6.2% in 1990. This hike was the last in a series enacted through various pieces of legislation going back to the early 1970s. It is higher than needed to meet today's social security costs, which are only consuming about 85% of the combined employee/employer rate of 12.4%. A recent proposal by Senator Moynihan to bring the rate more in line with actual costs has reopened the debate about how social security should be financed and treated in the Federal budget. He proposes bringing the rate down in 1990 to the 1989 level of 6.06%, with a further decline to 5.1% next year. The two-step drop would amount to an 18% cut in the relative tax bite. The "pay-as-you-go" concept underlying the proposal envisions a system where neither sizeable surpluses nor deficits would be allowed to emerge. This is in contrast to current law where substantial surplus receipts are expected until 2015 or so after which expenditures would outrun them (the system technically appears solvent until 2045-50 because of the large surpluses credited to the program's trust funds in earlier years). Eventually, the Moynihan proposal would lead to a tax rate of 8.1% in 2045 and later as the rate is adjusted to keep pace with rising costs.

Support for the proposal emanates from the belief that the surplus taxes are masking the Federal deficit and not being saved for the future. It also comes from those who think the social security tax is "regressive" and see the proposal as a way of forcing Congress and the Administration to consider increasing income taxes. Others contend that if the surpluses were allowed to continue, pressure would mount to spend them, thereby exacerbating the system's long-range problems. They argue that the proposal removes this temptation and gives the public a clearer perception of the system's long-run costs by having tax rate increases scheduled in the law for the next century. Yet others contrast the proposal to the Administration's push for a capital gains tax reduction -- i.e., more tax relief would go to the working man if social security taxes were cut. Finally, proponents say that the incentive to keep social security in the budget would be lessened since there would be little surplus to offset the deficit.

Critics point out that without making up for the revenue loss, the immediate tax reduction would increase the Government's borrowing from the public, and thereby reduce the amount of resources available for private investment -- it would impair the nation's savings rate, rather than bolster it to prepare for the demands of the next century. They contend that using the surplus receipts to reduce the budget deficit means the Government would borrow less. Less Government borrowing means more money would be available for investment in the financial markets. Moreover, if the tax schedule put in the law to achieve a pay-as-you-go system proved inadequate because of faulty assumptions, the system's financial solvency could be impaired, thereby eroding public confidence and threatening the benefit structure.

## ISSUE DEFINITION

The social security tax rate is higher than needed to meet today's social security costs. A recent proposal by Senator Moynihan to bring the rate more in line with actual costs has reopened the debate about how social security should be financed and treated in the Federal budget. Arguing that these surplus receipts are masking the budget deficit, the Senator proposes a pay-as-you-go approach that would reduce the tax rate during the next two decades but later raise it to keep pace with rising costs. Opponents argue the receipts are needed to increase national savings by helping to reduce Government borrowing from financial markets. They assert that implementing this tax cut now would potentially damage the economy and the social security system by increasing the overall deficit and reducing needed investment.

## BACKGROUND AND ANALYSIS

### A Few Basics About Social Security Financing

Financing for social security and the Medicare Hospital Insurance (HI) program is provided by flat-rate taxes levied on payrolls and self-employment income, commonly referred to as FICA (for Federal Insurance Contributions Act) and SECA (for Self-Employment Contributions Act) taxes. More than 95% of the work force is required to pay the tax, with the major exclusions being employees of State and local governments that have not elected coverage, and most Federal employees hired before Jan. 1, 1984. The FICA tax is levied on a worker's earnings and is paid both by employees and employers; the SECA tax is levied on net self-employment income. Investment and other forms of non-work income is not affected. Both the FICA and SECA rates have three components: one for Old Age and Survivors Insurance (OASI), a second for Disability Insurance (DI) -- and a third for HI.

**Table 1. Social Security Tax Rates Under Current Law (in percents)**

| | Employee Rate | | | | | Combined rate |
|---|---|---|---|---|---|---|
| | OASI | DI | OASDI | HI | Total | Employee/Employer |
| 1988-89 | 5.53 | 0.53 | 6.06 | 1.45 | 7.51 | 15.02 |
| 1990 | 5.6 | 0.6 | 6.20 | 1.45 | 7.65 | 15.3 |
| 2000 | 5.49 | 0.71 | 6.20 | 1.45 | 7.65 | 15.3 |

The rate for the self-employed is the same as the combined employee/employer rate; however, only 92.35% of net self-employment earnings is taxable and half of the SECA taxes so computed is deductible for income tax purposes.

The tax is not levied on earnings above a taxable earnings base (in 1990, $51,300). The base rises each year to reflect increases in average earnings in the economy. Approximately 9 out of every 10 workers have earnings below this level.

## Putting the Issue in Context

**Where do surplus social security taxes go?**

Contrary to popular belief, social security taxes are not deposited in the social security trust funds, but (like all other Government revenues) in the U.S. Treasury. Each day, they flow into 15,000 depository accounts maintained by the Government with financial institutions across the country and, along with many other forms of tax revenues, become part of the Government's operating cash pool. The social security taxes are accounted for separately through the posting of "non-marketable" securities to the social security and HI trust funds -- basically a bookkeeping entry by the Treasury. The accounts -- the trust funds -- do not receive money and the securities posted to them, as their label implies, have no commercial value because they cannot be sold in the marketplace (they are so-called *special issues of the Treasury*). Similarly, benefits are not paid from the trust funds, but from the Treasury. As the checks are paid, a corresponding amount of securities are written off the trust funds -- basically another bookkeeping entry.

If more social security money is collected than spent in any given month, does the money remain in the Treasury? No. Once the taxes are received, they become indistinguishable from other monies paid into the Treasury and are used to pay other Government obligations. That more social security taxes were received than spent is merely reflected in a higher balance of securities on the trust fund ledgers -- a higher amount of what are, in essence, IOUs.

**What is the purpose of the trust funds if their holdings have no commercial value?**

The securities posted to any Federal trust fund represent permission to spend, or what is technically referred to as *budget authority*. As long as there is a balance of these securities, the Treasury Department can keep issuing checks for the program. In social security's case, the trust funds largely have served a contingency purpose -- whenever their credited income fell below their outgo, the Treasury had permission to keep spending because of the budget authority held in *reserve* (i.e., the balances posted to the trust funds). The program's financial problem in the late 1970s and early 1980s was the threat that these balances would be totally depleted and the subsequent income posted to the trust funds would not keep up with the payment of benefits. Although the trust fund balances represent an accumulation of IOUs from the Government heavily based on past excess tax receipts, the trust funds themselves do not hold financial resources to pay benefits. Current receipts of the Government and amounts borrowed from the public (since the Government is running a deficit) are used to meet the commitments -- the trust fund balances merely provide authority to do so.

One should note that the interest credited to a Federal trust fund's balance can cause it to grow without "surplus" money being taken in by the Government on behalf of that program, or outlays from the Treasury. An interest payment posted to a trust fund is indistinguishable from any other security posted to the trust fund. Hence, a trust fund's projected "income" stream can grow without enhancing the

Federal revenues generated by the program and without requiring any outlay of Federal resources.

**Would taking social security out of the budget change where the surplus taxes go?**

The Federal budget is a summary of what Congress and the President want the receipts and expenditures of the Government to be. It is not a cash management account or investment vehicle -- it is simply a statement of what policymakers want the Government's financial flows to be during any given time period. Whether this summary is presented in a unified or fragmented form will not *in and of itself* change how much money is received and spent by the Government, and it will not alter where Federal tax receipts *of any sort* go. Social security taxes will go into the Treasury regardless of whether the program is counted in reaching budget totals. Social security taxes will go elsewhere only if Congress decides they will go elsewhere.

Proposals to remove social security from the budget are based on the supposition that Congress would act *differently* in trying to achieve deficit-reduction targets if social security surpluses were not counted in reaching the budget totals. This is a matter of conjecture, based on assumptions about whether Congress would ignore social security in devising the nation's overall fiscal policies, and whether social security's removal from the budget would be a catalyst for removing other programs from the budget process.

**Are surplus social security taxes giving the Government more money to spend?**

Using surplus social security taxes to help pay the Government's other bills does not necessarily mean that the Government has more money to spend than it would have if these receipts were not available. Decisions about social security and the finances of the rest of the Government have not been made in isolation of one another and those decisions have had overlapping influences. Social security taxes are only one form of Federal taxation. Increases in social security taxes may have made it more difficult for Congress to raise other forms of taxes. For instance, social security taxes were raised in 1977 to shore up the program's financing, but the following year income taxes were reduced to offset the impact of these hikes on individual taxpayers. Similarly, the Earned Income Tax Credit (EITC) is intended to offset the social security tax bite on low-income workers with children. Hence, other taxes may have taken the place of the surplus social security taxes if social security taxes were lower. Thus, whether these surplus taxes are allowing the Government to spend more is a matter of conjecture.

**Are surplus social security taxes causing the deficit to fall?**

On the surface, a quick look at the budget totals suggests an obvious "yes"; on thoughtful examination the answer is not clear. The unified budget deficit is a product of all spending and taxation decisions made by Congresses and Administrations over many years -- decisions that result today in more spending than tax receipts. The Government continues to cover the shortfall by borrowing money from financial markets. No single activity of the Government determines the

magnitude of this shortfall. To say surplus social security taxes are reducing the deficit assumes that all other spending and taxation decisions have always been made without any regard for social security's income and outgo, and vice versa. In fact, social security's annual cash flow has been included in the budget totals determined by Congress since enactment of the congressional budgetmaking process in 1974. Also, all Administrations as far back as the 1930s prepared either unified budgets or "consolidated" financial statements of the Government's operations that included social security. By the same token, when social security taxes were smaller than the program's spending -- as they were for all but 5 fiscal years after 1957 and through 1984 -- it is not clear that this shortfall raised the Federal deficit. Government borrowing from the public caused by deficits is not clearly linked to any particular aspect of what the Government does. It borrows as it needs to, for whatever obligations it has to meet.

As noted before, the recent social security tax increases may have made it more difficult than it otherwise would be to raise other taxes. Similarly, the surpluses they created may have reduced the pressure for reduced spending. Both effects would contribute to the deficit. However, the extent to which the surplus has had these effects, if at all, is not known. Thus, whether surplus social security taxes are actually reducing the deficit and allowing the Government to operate with less borrowing from the public is purely conjecture.

**Is the current era of surpluses a new phenomenon for social security?**

The original Social Security Act in 1935 was designed to build a large fund over several decades to help finance future benefits. Amendments enacted in 1939 attempted to alter this approach -- to move it toward a pay-as-you-go system -- but with robust receipts stemming from the economic expansion associated with the subsequent war effort, it was many years before the program's receipts came into alignment with its expenditures. During the early 1940s, social security tax receipts were 6 or 7 times the program's expenditures, and even at the end of the decade they were still 2 1/2 times the outgo. It was not until FY1957 that tax receipts and outgo came close to a 1-to-1 relationship. In most years after FY1957, up through 1984, tax receipts fell slightly below the program's outgo. Thus, while the collection of surplus social security taxes is not a new phenomenon, it has not been a cause for debate for many years.

**What legislation caused the surpluses?**

One of the misconceptions concerning the surpluses is that they were caused by the 1983 Social Security Amendments, particularly by tax increases enacted then. Actually, actuaries and analysts had known for years that the cost of social security would rise in the future because of the post-World War II baby boom and subsequent drop in the birth rate. This was reflected in the 1972 Social Security Amendments, which called for a series of increases in the tax rate raising it from 5.15% (employee/employer, each) in 1972 to an ultimate rate of 5.85% in 2011. Amendments in 1973 raised the ultimate rate to 5.95%. Amendments in 1977 accelerated these increases and raised the ultimate rate to 6.2%, effective in 1990, as part of a package of tax and benefit changes to shore up the system. The 1983 amendments, again attempting to shore up the system's financing with tax and benefit changes, left the 6.2% rate in place for 1990, but phased in part of the

increase in 1988 and 1989 (they also accelerated a 1985 increase into 1984). Even before the 1983 amendments, surpluses were projected to occur in or around the turn of the century; the 1983 amendments simply made them larger.

**Did Congress legislate them intentionally?**

Did Congress deliberately adopt a policy of building a social security fund with surplus taxes to provide money to meet higher social security costs in the future? Did it think that the surplus taxes would indeed materialize and be "saved" in some real sense by being invested in Federal securities? An examination of the record of committee proceedings leading up to the 1983 amendments, and the earlier deliberations of the National Commission on Social Security Reform (a bipartisan panel set up in 1981, whose recommendations served as a basis for the 1983 amendments) shows only passing references to the possibility of future surpluses. The record does not show that Congress actually considered building a fund or how such a fund would actually save resources. Congress and the Commission were concerned about whether their proposals would keep the system's income and outgo in balance under pessimistic economic conditions in the near term (through the end of the decade). While near-term surpluses were estimated to result under a middle ground forecast, referred to as the Intermediate II-B assumptions, greater emphasis was placed on whether the changes would keep the program solvent under a pessimistic forecast. The latter showed a relatively modest spread between income and outgo, and an accumulated surplus equal to only a few months' benefits.

As for the long-run problem, the attention of Congress and the Commission was drawn to an *average* financial imbalance over the following 75 years. It was widely understood that the program was in immediate trouble, and that a long-range deficiency would emerge at some point well after the turn of the century. But when the long-range problem was discussed, it was usually in terms of an average 75-year shortfall, or the effect that various measures would have on that average, not on how the proposals would affect the program's income and outgo year by year. The public record does not indicate that Congress was shown what the amendments would do to the year-by-year pattern of income and outgo after 1992. Getting rid of the average deficit was the goal. This emphasis made discussion of the system's financing problem simpler -- it consisted of a short-run problem of a given amount of dollars and a long-range problem of a given amount of taxable payroll. This was of no minor utility in a highly charged political atmosphere, where a rapidly changing baseline, many different sets of future projections, and an exhaustive list of proposals created enormous difficulties in reaching agreement.

**How much surplus is projected now?**

The 1989 Social Security Trustees Report shows that under all of its four forecasts, social security tax receipts exceed the program's expenditures for the next two decades. Under the intermediate II-B forecast, tax receipts in 1990 would be $50 billion (or 20%) larger than expenditures. They would be $104 billion (23%) larger in the year 2000, with the peak spread of $160 billion occurring in 2010. Sometime in the 2015-2020 period, expenditures would exceed tax revenues, and this would continue indefinitely.

The shift from surpluses to shortfalls results from swings in the system's relative costs. When shown in terms of the tax rate that would have to be imposed each year on the nation's payrolls to cover the expenditures, the costs fall by 3% between now and 2005, and then rise by 58% between 2005 and 2030. Put another way, if social security were financed on a pure pay-as-you-go basis and exclusively from the payroll tax, that tax would fall from 10.5% of the nation's payrolls today to 10.25% in 2005 and then rise again to over 16% by 2030. In terms of the relative effect on the economy of these swings, the program's costs are projected to drop from 4.58% of gross national product (GNP) today to 4.41% in 2005, but then rise to 6.7% by 2030 (which would be more than a 50% increase in S.S.'s relative share of GNP).

**TABLE 2. Long-Range OASDI Costs (Expressed as % of taxable payroll and GNP)**

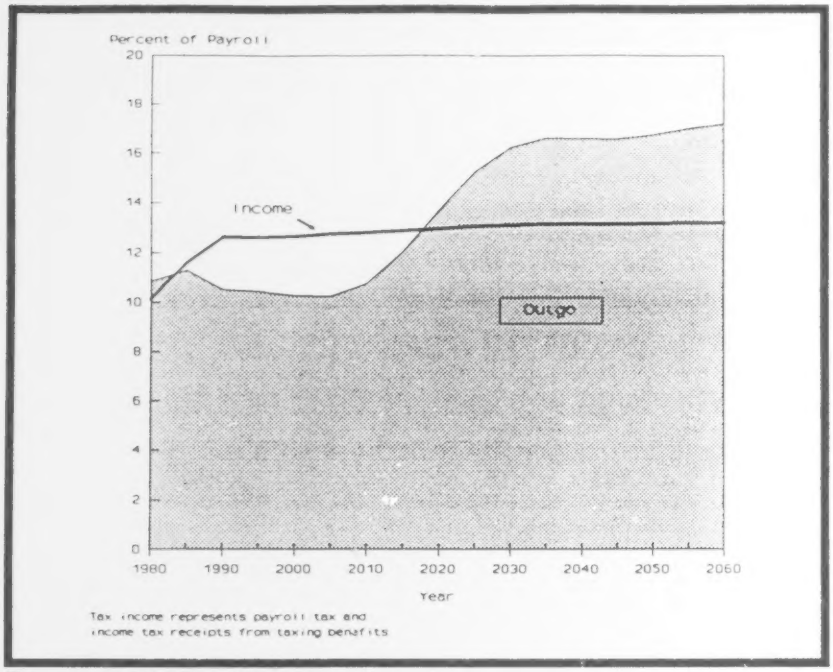
| Year | Taxable payroll | GNP |
|---|---|---|
| 1990 | 10.52 | 4.58 |
| 2000 | 10.27 | 4.45 |
| 2005 | 10.25 | 4.41 |
| 2010 | 10.76 | 4.60 |
| 2020 | 13.70 | 5.75 |
| 2030 | 16.23 | 6.68 |
| 2040 | 16.58 | 6.69 |
| 2060 | 17.19 | 6.68 |

Source: 1989 Trustees' Report, Intermediate II-B forecast.

However, under current policy social security tax receipts are **not** projected to rise and fall in tandem with the system's costs. The tax rate is scheduled to remain level at 12.4% indefinitely. Tax receipts are considerably more than is needed to finance projected costs through 2017, and when coupled with income credited to the trust funds for interest, the system's total income is projected to exceed its outgo (in some years by more than 50%) until about 2030. The nominal size of the trust funds (i.e., the accumulated IOUs) would peak then at $11.9 trillion. In real (uninflated) terms, the peak would have occurred 10 years earlier, when the trust fund balances would have reached $2.8 trillion in 1989 dollars.

After 2017, tax receipts are projected to be smaller than outgo, but the system is presumed to draw on its large trust fund balances resulting from the excess income that arose during the preceding 30 years. However, the trust fund holdings would simply represent a claim on the Government's other sources of revenue. Because the trust funds themselves would not provide the resources to pay the benefits, how these resources would be obtained poses a major long-range policy question. Basically, the Government would have to raise other taxes, cut other expenditures, or increase its borrowing from the public to finance the social security benefits. Presuming these actions were taken, the reserve would offset the shortfall in social security revenues until 2046, at which point the system would have exhausted its reserves and be technically insolvent (meaning that taxes would have to be raised or benefits would have to be cut).

**CHART 1. Social Security Cost Rates and Tax Income Rates, 1990-2060**




**Source: 1989 Trustees Report.**

**TABLE 3. Long-Range OASDI Trust Fund Operations**

| Calendar year | Income (excl. interest*) | Outgo | Difference | Interest | Trust Fund Balance |
|---|---|---|---|---|---|
| | Dollars (in billions) | | | | |
| 1990 | $ 303 | $ 253 | $ 50 | $ 19 | $ 237 |
| 1995 | 414 | 344 | 70 | 54 | 734 |
| 2000 | 562 | 458 | 104 | 98 | 1,582 |
| 2010 | 1,017 | 857 | 160 | 271 | 4,816 |
| 2020 | 1,736 | 1,838 | (102) | 550 | 9,576 |
| 2030 | 2,925 | 3,629 | (704) | 699 | 11,930 |
| 2045 | 6,393 | 8,072 | (1,678) | 120 | 1,446 |

*Payroll tax contributions, income from taxation of benefits, and miscellaneous reimbursements from the general fund.
Source: 1989 Trustees' Report, Intermediate II-B forecast.

This forecast reflects the effect of the post-World War II baby-boom generation's retirement and an aging population. During the next few decades, the baby boomers will be in their prime productive years, and the baby-trough generation of the 1930s will be in its retirement years. These two factors are projected to keep the ratio of workers to social security recipients fairly stable for the next 20 years. When the baby boomers retire, the number of workers per recipient is projected to fall steadily, reaching 1.8 around 2060.

**TABLE 4. Long-Range Ratio of Workers Per Social Security Recipient**

| Workers per social security recipient | | | | | |
|---|---|---|---|---|---|
| 1990 | 2010 | 2020 | 2030 | 2040 | 2060 |
| 3.3 | 3.0 | 2.4 | 2.0 | 1.9 | 1.8 |

Source: 1989 OASDI Trustees' Report, Intermediate II-B forecast.

**How would a pay-as-you-go system (e.g., Senator Moynihan's proposal) alter the situation?**

The social security tax rate (excluding the HI portion), paid both by employee and employer, rose from 6.06% to 6.2% in 1990 (see Table 1.). It is higher than needed to meet today's social security costs, which consume about 85% of the combined employee/employer rate of 12.4%. A recent proposal by Senator Moynihan (S. 2016) would bring the rate more in line with actual costs. He proposes dropping the rate to the 1989 level of 6.06%, with a further decline to 5.1% next year (an 18% cut in the tax.) The "pay-as-you-go" concept underlying the proposal envisions a system where neither deficits nor large surpluses would occur. Under current law substantial surplus receipts are expected until 2017 or so, after which expenditures would outrun them. Under the Moynihan proposal the tax rate would rise in steps to 8.1% in 2045 and later as it is adjusted to keep pace with rising costs (see the middle column in the following table).

However, there is no single pay-as-you-go approach. The tax rate could be adjusted frequently to keep social security revenues fairly close to the immediate obligations of the program, or it could be adjusted at longer intervals with small surpluses occurring in the intervening periods that would gradually fall until the next increase took place. The latter might involve only 3 or 4 changes in the tax rate over the next 30 or 40 years.

An approach that envisions frequent adjustments illustrates the dimensions of the tax rate changes that would have to take place under current cost projections (again, the Intermediate II-B forecast of the 1989 Trustees report). *If social security were financed exclusively from the payroll tax*, the tax rate would be approximately the cost rate -- meaning that the combined employee/employer rate could be dropped today from 12.4% to about 10.5%. Over the next 15 years it could be reduced a little more -- to a low point of about 10.2 to 10.3% in the year 2005 -- and then it would

begin a fairly rapid ascent, reaching 12% in 2015, 15.2% in 2025 and even higher levels by the middle of the century (see far right hand column of the following table).

Social security, however, is not financed exclusively with payroll taxes -- a small but growing portion of its receipts comes from income taxes levied on social security benefits, and, in addition, interest on its trust fund holdings (the latter being only a charge against the Government -- i.e., not derived from receipts from the public). If the program were to rely on both its payroll and income tax receipts (ignoring interest, since the idea would be to keep such a fund relatively small), the payroll tax would be somewhat lower than the cost rate. The combined employee/employer rate could be dropped from 12.4% today to a low point of 9.9% in the year 2005 -- after which it would begin a fairly rapid ascent to 16% in 2050. (see the second column from the right in the following table.)

**TABLE 5. Comparison of OASDI Tax Rates Required Under Current Law and Pay-As-You-Go System, 1990-2050 (employee/employer combined)**

| Calendar Year | Current law | (S.2016) (Moynihan) | Pure pay-as-you-go tax rate* | Cost rate |
|---|---|---|---|---|
| 1990 | 12.40% | 12.12 | 10.29% | 10.52% |
| 1995 | 12.40 | 10.20 | 10.23 | 10.44 |
| 2000 | 12.40 | 10.20 | 10.02 | 10.27 |
| 2005 | 12.40 | 10.20 | 9.91 | 10.25 |
| 2015 | 12.40 | 12.40 | 11.55 | 12.03 |
| 2020 | 12.40 | 14.00 | 13.13 | 13.70 |
| 2025 | 12.40 | 15.40 | 14.57 | 15.23 |
| 2035 | 12.40 | 15.40 | 15.87 | 16.61 |
| 2050 | 12.40 | 16.20 | 15.98 | 16.74 |

Source: 1989 OASDI Trustees' Report, Intermediate II-B forecast.
* The payroll tax would continue to be supplemented by income from taxation of benefits to achieve a match with the cost rate.

In layman's terms, a pure pay-as-you-go system would permit the relative tax bite to be cut by 20% or so for the next 15 years (from 12.4 today to about 9.9%), after which it would have to climb by 60% (from 9.9% in 2005 to almost 16% in 2050). In other words, taxes could be lower than currently scheduled in the near term, but they would have to be substantially higher than scheduled in the long run.

**TABLE 6. Potential Changes in Worker's Social Security Taxes Under S. 2016 (Moynihan)**

| Relative Wage Level | Current law | Increases and Reductions in Worker's Annual OASDI Taxes* [() = reductions] | | | | |
|---|---|---|---|---|---|---|
| | (6.2% rate) | 1990 | 1991 | 2015 | 2020 | 2025 |
| $10,000 | $ 620 | ($14) | ($110) | 0 | $80 | $150 |
| $20,000 | 1,240 | (28) | (220) | 0 | 160 | 300 |
| $30,000 | 1,860 | (42) | (330) | 0 | 240 | 450 |
| $40,000 | 2,480 | (56) | (440) | 0 | 320 | 600 |
| $50,000 | 3,100 | (70) | (550) | 0 | 400 | 750 |

*Wages will rise over time, but they were fixed in this table to show the relative change in the tax bite in today's terms.

## The Issue and Various Approaches to Address It

The proposal by Senator Moynihan reopened the debate about how social security should be financed, but the issue involves more than the appropriate level of social security taxes. Foremost are two questions: if more social security taxes are being collected than are needed for social security spending, how should they be used; and if they are not to be collected, what should take their place?

Support for the proposal emanates from the belief that the surplus taxes are masking the Federal deficit. For instance, if the social security surpluses are not counted in the FY1989 budget totals, the Federal deficit would be shown to have been $205 billion, instead of $152 billion -- $53 billion higher. At the root of the issue is the public's misperception that the surplus taxes are deposited and saved in the social security trust funds, which they are not. The money goes into the Treasury, and out again almost immediately. The concern is that crediting them to the trust funds, but using them for something else, deceives the public. Hence, supporters contend that if some portion of the social security tax is not being used for social security purposes, it should not be levied. Support also comes from those who think the tax is "regressive," or at least not as progressive as the income tax, which has a graduated rate schedule and is levied on other income besides earnings from work. They contend that for many families, social security taxes are greater than income taxes, and that other taxes should be used to finance that portion of the Government's spending now financed with the surplus social security receipts. They see the proposal as a way of forcing Congress and the Administration to do this.

Others contend that the surpluses are just an invitation for new spending. They see them as a potential source either for expanded social security benefits -- the creation of which could exacerbate the system's long-range problems -- or for other new social programs. Currently, the existence of large Federal deficits acts as a fiscal constraint, but if the deficits were eliminated or reduced to a more manageable level -

- say by the middle of the 1990s -- they fear that pressure would mount for new spending initiatives. Yet others point out that a pay-as-you-go approach would give the public a better sense for the system's long-run costs by having tax rate increases scheduled for the next century. In the long run, projected tax receipts are inadequate to cover benefits, but the buildup of the trust fund makes it appear as if the resources will be there. Since the trust funds hold only Government securities (IOUs), they would not provide the money. Other taxes would have to be raised, other spending reduced, or borrowing increased. Hence, they contend that scheduling social security tax rate increases in the future would show more directly that the money for future benefits will have to come out of the economy at that time. Yet others contrast the proposal to the Administration's push for a capital gains tax reduction. They argue that if Congress is to consider tax reductions, a social security cut would give more relief to the working man or woman than a capital gains cut that benefits those with substantial income from assets -- i.e., the wealthy. Finally, some who fear that budgetary pressures could lead to calls for cuts in social security benefits support a pay-as-you-go approach because it would weaken the incentive to keep social security in the budget (since there would be little surplus to offset the deficit).

Critics point out that if the proposal's revenue loss is not offset, it would merely increase the overall deficit and lead to more Government borrowing from the public, thereby reducing the amount of resources available for private investment. They warn that this would impair, rather than bolster, the nation's savings rate, and thus would not prepare it for the demands of the next century. The consensus among economists is that the unified budget deficit -- which is the amount the Government borrows each year from the public -- is too large, and that the accumulation of past deficits has already imposed a large mortgage on future generations. Cutting social security taxes now without offsetting fiscal measures will only make that amount larger. Estimates from the Congressional Budget Office (CBO) show a revenue loss for the Government of $50 billion in CY1991 rising to $65 billion in 1995. The cumulative revenue loss over the CY1990-95 period would be almost $300 billion. Critics contend it will be difficult enough for Congress to achieve the Gramm-Rudman deficit targets counting all existing receipts; hence, they ask where the other part of the proposal is -- the painful part. They argue that using the surplus receipts to move toward a balanced budget is tantamount to saving them since less Government borrowing means more money is available for private investment.

Others have argued that reducing the tax schedule today, even though a substantial contingency reserve is already posted to the trust funds, subjects the program to potential financing risks. The public still appears to be apprehensive about the long run survivability of the program -- despite the repeated reports of surpluses -- and another round of financial problems could do severe damage to the program's credibility. Trust fund balances that initially appeared to be large in the past turned out to be inadequate, and it would be hard to predict how much of a reserve would be adequate to cushion the program from economic setbacks. Social Security Administration actuaries recently estimated that while Senator Moynihan's proposal would result in combined OASDI trust fund balances equal to about one year's worth of expenditures throughout the decade under the Intermediate II-B assumptions (the middle ground forecast), under pessimistic assumptions the DI fund would be exhausted in 1997 (the combined funds' balances would fall to 2 months' worth of expenditures at the beginning of 1998). Yet others argue that while the

social security programs are projected to have large surpluses, the HI portion of Medicare is projected to become insolvent sometime around the turn of the century, and the surplus OASDI taxes may need to be allocated to that program. Finally, critics contend that whether the social security tax is regressive is not clear. They argue that the regressivity of the tax is offset by a progressive benefit schedule that pays more social security benefits per tax dollar to low wage earners than high wage earners. Moreover, they point out that for the 90% of the workforce whose earnings fall below the earnings base, the tax is actually a proportional one on earnings, and that for families with children with annual earnings up to about $20,000, the Earned Income Tax Credit (EITC) offsets most or all of their social security taxes.

The Administration has opposed the Moynihan plan, suggesting instead that after 1993 (i.e., after the budget would be balanced if the Gramm-Rudman targets were met) an account be set up through which surplus social security taxes would gradually be used to buy up outstanding Federal securities held by the public. The account would be displayed as an outlay in the budget. The plan's basic thrust is to run unified budget surpluses after 1993 equal to a growing portion of the social security surplus receipts, using that money to reduce the amount of debt owed to the public (which happens, perforce, when the Government runs a unified budget surplus). The plan changes neither how much money the Government takes in or spends, nor where the social security surpluses are invested (the trust funds would still hold Federal securities). The Administration's plan basically is a *process* change aimed at keeping the surpluses from being spent.

Other bills introduced in the Senate include one by Senator Kasten (S. 2052) to cut the tax rates by smaller amounts than the Moynihan bill (setting the rates at 5.9% in 1990, 5.6% in 1991, and 5.3% in 1992 and later). He also proposes removing social security from the budget totals for Gramm-Rudman deficit reduction purposes and postponing the point of eliminating the deficit until 1997. As with the Moynihan bill, it leaves the issue of how the Government would deal with the revenue loss in the near term and how the system would be kept solvent in the long run. Under current projections, a rate of 5.3% would become inadequate to keep the system solvent some time between 2010 and 2015. Similar legislation has been introduced by Representative Hank Brown (H.R. 3937) and Representative Williams (H.R. 3872).

An alternative approach proposed by Senator Symms (S. 2026) would provide a worker with a credit, initially set at 1% of taxable earnings, which would then be deposited, either in a "family savings plan" account established by an employer or one established by the Government. In subsequent years the credit would be based on the surplus portion of the tax as estimated annually by the trustees. It would be a pay-as-you-go approach to the financing of social security, but would direct the surplus portion of the taxes into individual savings accounts (so long as a surplus exists). Representative Porter has talked about a related proposal that calls for depositing the surpluses into private IRA or 401 (k) type retirement accounts.

Other bills in the House that would lower the OASDI tax rate are H.R. 302 (S. Neal), H.R. 349 (Roe), H.R. 3857 (Dorgan), and H.R. 3865 (Penny). H.R. 302

would place OASDI on a true pay-as-you-go basis by adjusting the tax rate as necessary to keep a reserve of 60% of one year's outgo. H.R. 349 would not only lower the OASDI rate to 5.5% until 2005, it would also repeal the HI tax (the HI program would be funded by an earmarked income tax). H.R. 3857 would simply repeal the 1990 OASDI tax increase. H.R. 3865 also would repeal the 1990 increase, and would drop the rate further in 1990 and thereafter to 5.1%.

Another alternative, suggested by Senator Hollings, would be to alter the social security tax rate along the lines proposed by Senator Moynihan but to make up for the revenue loss with a value added tax (VAT). Another proposal, by Senator Sasser, would reduce social security taxes initially by a smaller amount than under Senator Moynihan's proposal, but by 1997 the reduction would be larger. The tax rate would gradually drop to a level of 4.55% then, in contrast to the 5.1% rate that would prevail under Senator Moynihan's proposal and the 6.2% rate under current law. (A tax rate schedule for the Sasser proposal for years after 1997 was not available at the time of this writing.) His proposed tax cuts would be contingent upon making even larger cuts in the Federal budget deficit. It should be noted that his proposal also would reduce social security trust fund balances to precariously low levels in 1998 under pessimistic conditions. A variation of this approach that would avoid cutting the trust fund balances, attributed to Representative Gephardt, would be to give middle-income taxpayers an income tax credit rather than a cut in the social security tax.

## LEGISLATION

**H.R. 302 (S. Neal)**

Amends the Internal Revenue Code of 1986 to provide for floating rates for OASDI. Introduced Jan. 3, 1989; referred to Committee on Ways and Means.

**H.R. 349 (Roe)**

Amends the Social Security Act to reduce social security taxes and apply the proceeds thereof to the financing of the OASDI program, and to finance the Medicare program from general revenues. Introduced Jan. 3, 1989; referred to Committee on Ways and Means.

**H.R. 3085 (Penny)**

Amends the Internal Revenue Code to repeal the 1990 scheduled increase in the social security taxes and to reduce such taxes in 1991. Introduced Jan. 23, 1990; referred to Committee on Ways and Means.

**H.R. 3857 (Dorgan)**

Amends the Internal Revenue Code of 1986 to repeal the 1990 increase in social security taxes. Introduced Jan. 23. 1990; referred to Committee on Ways and Means.

**H.R. 3872 (Williams)**

Amends the Internal Revenue Code of 1986 to repeal the 1990 OASDI tax increase and to exclude social security from Gramm-Rudman deficit calculations. Introduced Jan. 23, 1989; referred to Committee on Ways and Means. (Essentially similar legislation is contained in **H.R. 3937 (H.Brown)**.)

**S. 2016 (Moynihan)**

Amends the Internal Revenue Code to alter the social security tax schedule. Introduced Jan. 23, 1990; referred to Committee on Finance.

**S. 2026 (Symms)**

Social Security Benefits Enhancement Act. Amends the Internal Revenue Code to allow employees to have a percentage of social security contributions made to a qualified pension plan. Introduced Jan. 25; referred to Committee on Finance.

**S. 2052 (Kasten)**

Amends Internal Revenue Code to reduce social security taxes and remove social security from the budget. Introduced Feb. 1, 1990; referred to Committee on Finance.

## CONGRESSIONAL HEARINGS, REPORTS AND DOCUMENTS

U.S. Congress. Committee on the Budget. Budget targets and the treatment of social security. Hearing, 101st Congress, 1st session. Sept. 19, 1989. Serial No. 101-8. Washington, U.S. Govt Print. Off. 110 p.

U.S. Congress. Joint Economic Committee. The social security trust fund surplus. Hearing, 101st Congress, 1st session. June 15, 1989. S. Hrg. 101-218. Washington, U.S. Govt Print. Off. 78 p.

## FOR ADDITIONAL READING

U.S. Library of Congress. Congressional Research Service. The social security surplus: a discussion of some of the issues, by David Koitz. [Washington] Nov. 21, 1988. 48 p.
CRS Report 88-709 EPW